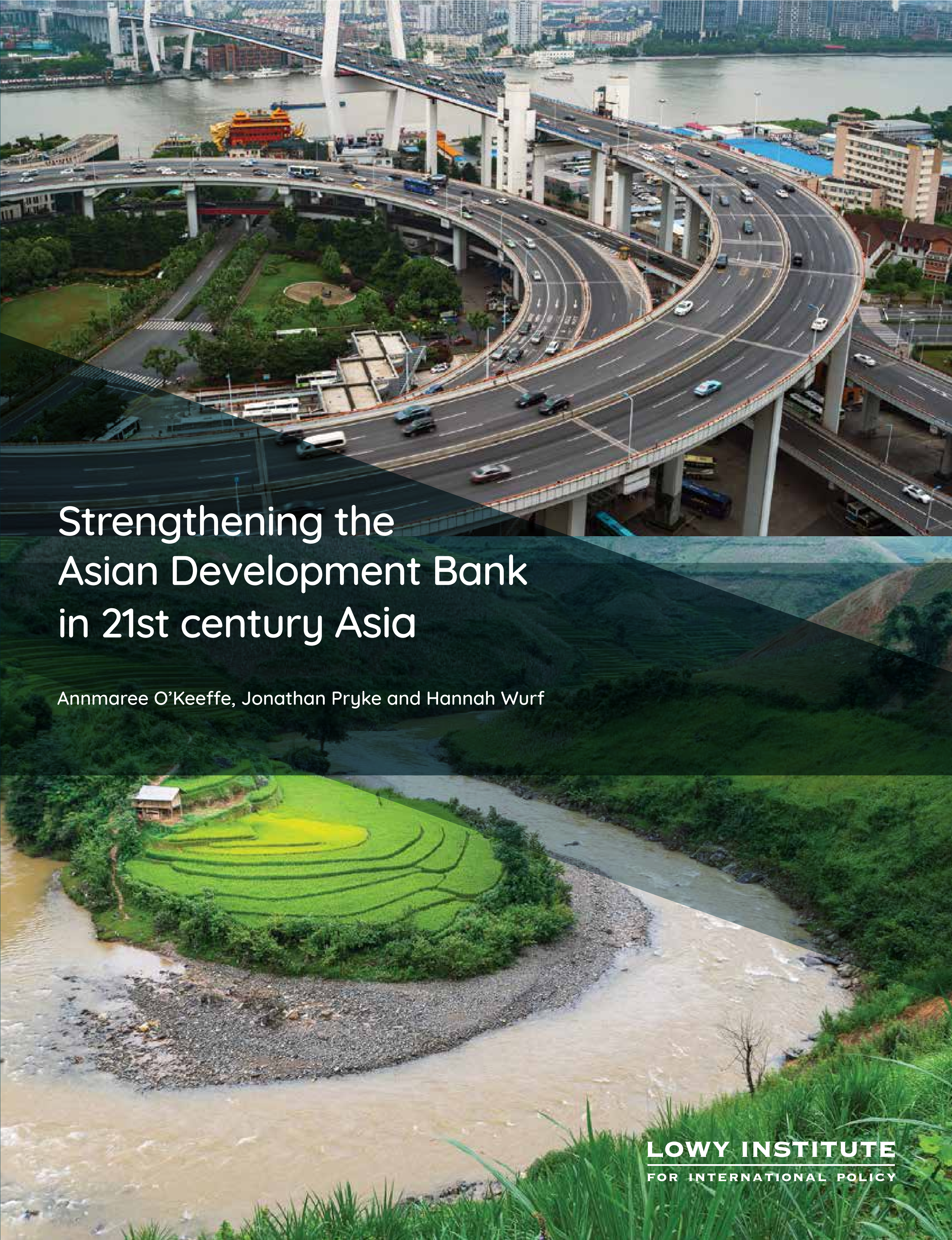

Strengthening the Asian Development Bank in 21st century Asia

Annmaree O'Keeffe, Jonathan Pryke and Hannah Wurf

LOWY INSTITUTE
FOR INTERNATIONAL POLICY

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Published in February 2017 by the
Lowy Institute for International Policy
Level 3, 1 Bligh Street
Sydney NSW 2000 Australia
www.lowyinstitute.org

This report is available electronically in HTML and PDF formats on the Lowy Institute's website:
https://www.lowyinstitute.org/publications/strengthening-asian-development-bank-21st-century-asia.

ISBN 978-1-921004-20-9 (Print)
ISBN 978-1-921004-21-6 (PDF)

Cover design: Ilse Holloway
Cover photos: Getty Images/Dong Wenjie; Nuttawut Jaroenchai
Printed and bound in Australia by MegaColour

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EXECUTIVE SUMMARY

Despite rapid economic growth and increased prosperity across the Asian region, there is widespread poverty and deep inequality. The Asian Development Bank serves the Asia-Pacific region by providing local and regional public goods, particularly physical infrastructure. In all its dealings, the Bank brings good safeguards and its AAA credit rating.

There is still need for an Asian Development Bank in the 21st Century. However, there are three long-term challenges for the Bank: navigating the evolving geopolitical dynamics of Asia; fulfilling its mandate for economic development and poverty reduction while responding to Asia's changing economic geography; and harnessing alternative economic models to remain a source of finance.

Chapter 1 of this report makes the case for the Bank to remain neutral in an increasingly fraught geopolitical environment while also considering governance reform to give more influence to regional members. Chapter 2 argues the Bank should stay within its mandate and prioritise key areas that affect the economic and social development of Asian countries. Chapter 3 explains the Bank's advantages over other finance sources and how the Bank can also think about more creative financing options. The report concludes with recommendations for the Bank and its members.

Recommendation 1: The Bank's role as a well-respected neutral development actor is even more important as geopolitical tensions and uncertainty in Asia mount. To underpin this role, it should be more vocal about the value of its development credentials and the high standards they represent.

Recommendation 2: The ADB needs to work towards more representative governance with a greater voice for regional members. This requires giving China and India more influence, while not compromising the Bank's existing mandate.

Recommendation 3: The ADB should keep engaging with new actors in the region.

Recommendation 4: Addressing poverty should remain the first priority of the Bank through maintaining its focus on infrastructure and connectivity as well as environmental issues, particularly the impact of climate change.

Recommendation 5: ADB shareholders and management need to accept that the development agenda is much bigger than what the ADB and its resources can manage. Focus needs to be maintained to stop the Bank straying from its strengths.

Recommendation 6: The ADB should continue to play to its strengths and champion those projects that contribute to the public good but which might not otherwise be funded.

Recommendation 7: The ADB's graduation policy must be reformed.

Recommendation 8: The Bank should continue to experiment in lending in creative ways and maintain its portfolio of concessional lending activities.

Recommendation 9: The ADB needs to maintain high standards in all stages of a project's lifecycle. This includes front-end planning, contracting and procurement, as well as back-end project supervision, monitoring, and appraisal.

Recommendation 10: The Bank should consider a general staffing increase comparable with those that have followed past general capital increases.

Recommendation 11: The ADB must open up its hiring policies at all levels of the Bank.

Recommendation 12: Funding for technical assistance should be streamlined and maintained at appropriate levels to create a pipeline of bankable infrastructure projects in Asia, not just those that the Bank looks to invest in.

Recommendation 13: Staff and decision-making should be further decentralised from Manila, while maintaining an appropriate hierarchy.

PROJECT APPROACH

This report looks at the role of the Asian Development Bank in 21st century Asia. For the purposes of this report, 'Asia' and the 'Asian region' are defined as encompassing the Bank's 33 Asian member countries, unless otherwise stated.[1] Asian member countries have received 97.5 per cent of total lending (in inflation adjusted terms) over the ADB's history.[2] The report excludes the Pacific Island countries, Australia, and New Zealand in its definition of Asia. Box A in Chapter 2 of this report explains briefly why the Pacific warrants a different approach by the ADB given the unique development challenges the region faces.

This report does not endeavour to offer an Australian perspective on the Asian Development Bank. Its audience is all the major donors of the Bank, in particular the developed member countries which have the influence and financial input to affect the Bank's decisions. The authors hope that it is relevant to all stakeholders of the Bank, recognising that there are different perspectives among the Board of Directors and within the Bank's management.

The findings of this report are based on qualitative and quantitative research, including semi-structured interviews with key stakeholders and analysis of the ADB's own data. The authors conducted more than 60 interviews in Manila, Beijing, Washington DC, Tokyo, and Canberra, speaking with officials and independent experts. Two authors spent a week at the ADB's Manila headquarters and conducted 18 interviews with directors, vice presidents, and senior staff of the Bank. The third author attended the Bank's 2016 annual meeting in Frankfurt, which enabled access to developed and developing member country perspectives. The authors interviewed both current and past Bank officials.

Following the interviews, the research team conducted a workshop under Chatham House rules to test their preliminary findings and observations with a group of development experts and economists from the region. This included representatives from the Asian Development Bank, government officials, and civil society actors.

The report received comments from four peer reviewers and underwent an external fact-check. Any errors or omissions are the responsibility of the authors.

The project was funded by a grant from the Smith Richardson Foundation to the Lowy Institute for International Policy.

ACKNOWLEDGMENTS

This report would not have been possible without the cooperation of the Asian Development Bank and the generosity of our interviewees.

The authors would also like to thank Deputy Director of the Lowy Institute Anthony Bubalo and Research Editor Lydia Papandrea, external peer reviewers, and Peter McCawley for his feedback throughout the project.

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LIST OF FIGURES, TABLES AND BOXES

FIGURES

** These Figures are also available as interactive charts in the online version of this report.*

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ABBREVIATIONS

ADB	Asian Development Bank
ADF	Asian Development Fund
AfDB	African Development Bank
AIIB	Asian Infrastructure Investment Bank
BRICS	Brazil, Russia, India, China and South Africa
CSO	civil society organisation
DMC	developing member country
EBRD	European Bank for Reconstruction and Development
FDI	foreign direct investment
GDP	gross domestic product
GNI	gross national income
HDI	Human Development Index
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
IEA	International Energy Agency
IFIs	international financial institutions
IMF	International Monetary Fund
MDB	multilateral development bank
NDB	New Development Bank
NGO	non-government organisation
OCR	ordinary capital resources
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OOF	other official flows
PPPs	private-public partnerships

QWIDS	Query Wizard for International Development Statistics
SDGs	Sustainable Development Goals
TPP	Trans-Pacific Partnership
UNDP	United Nations Development Programme
UNESCAP	United Nations Economic and Social Commission for Asia and the Pacific

Unless otherwise stated, all dollar figures cited are in US dollars.

INTRODUCTION

In 1966, 31 countries came together to found the Asian Development Bank (ADB or the Bank). At the time, the region faced profound development challenges. Much of Asia was still recovering from the destruction of the Second World War. War, revolution, and poverty were prominent features of the Asian landscape. China was in the throes of major upheaval in the form of the Cultural Revolution and the country suffered from enduring agricultural and industrial stagnation. Vietnam, following its division into North and South after the French withdrawal, was entering another bloody conflict that would endure until the mid-1970s. The new state of Malaysia was in the final throes of armed confrontation with the newly independent Indonesia. India and Pakistan were still struggling with the after-effects of violent partition.

The region-wide social and economic tumult made Asia an important theatre for the Cold War as the many new countries of the region sought out the best model for economic development. The United States and its allies supported the ADB in part because they believed that increased prosperity would reduce the appeal of communism. The ADB was part of the Bretton Woods architecture established by the United States after the Second World War that would play a defining role in global development in the second half of the 20th century.

In Washington DC, the International Monetary Fund (IMF) was established as the cornerstone institution of the monetary system to act as a global safety net in case of financial instability, while the World Bank was set up for post-war reconstruction and development. In the ensuing decades, a suite of multilateral development banks (MDBs) were established to operate in a similar way to the World Bank at the regional level. The ADB was one of these institutions. While operating within their own structures and focusing on regional needs, these development banks remained part of the Bretton Woods international financial architecture.[3] The international financial institutions (IFIs) are integral to development not only because of the funds they provide, but also through their expertise and ability to help shape the international economic development agenda.

Fifty years after the establishment of the ADB, Asia faces an entirely new set of development challenges. Some countries have grown prosperous, but their wealth is not evenly distributed and the region still hosts many of the world's poorest people. The benefits of infrastructure development and connectivity in the region have not been realised. At the same time, the very concept of development is changing in a region increasingly threatened by the effects of climate change. As Asian governments seek to provide a better quality of life for their citizens, they have an expanding range of options from public and private sector institutions to consider beyond the ADB. This report seeks to answer how the ADB can remain an attractive and influential development actor in 21st century Asia.

CHANGING ASIA, CHANGING ADB

Since it was founded, the ADB has evolved from its initial focus on promoting food production and rural development to supporting large infrastructure projects and the adoption of poverty reduction as its primary focus. In 1968, the Bank's capital base was $4.6 billion (in inflation adjusted terms), with 32 member countries.[4] As at 2015, the Bank's capital base was $147 billion and it now has 67 member countries.[5]

The ADB has a good reputation in the region for understanding the needs of its borrowers and staying politically neutral. The ADB has been able to facilitate regional projects even in parts of Asia where relations between neighbouring countries are tense or difficult, for example in South and Southeast Asia. The ADB's comparative advantage is providing financing for public infrastructure and public goods, and complementing loans with essential technical expertise and 'best practice' approaches to development. Historically, the ADB was able to lend to many Asian countries that were otherwise unable to attract external financing. The ADB also responded quickly to the 1997 Asian financial crisis and scaled up its lending appropriately. Given the Bank's profitability and strong credit rating, it is able to lend more than $16 billion a year without a significant financial burden on the Bank's shareholders. The ADB will have new lending opportunities with the merger of the two arms of its capital base in January 2017, which will dramatically increase its lending ability. The Bank is therefore in a good position to reinforce its role in the region with its replenished capital base and strong reputation for impartiality.

But the ADB has its critics too. Non-government organisations charge that the Bank has failed to take into account the impact of its projects on the environment and on local communities. There have been instances where ADB projects have been compromised because a member country has pressured the Bank to use its national contractors, even if they were not the best available. A number of borrowing countries complain that working with the Bank is too slow, laborious, and bureaucratic, although this is a complaint levelled at all the MDBs. The ADB is aware of many of these criticisms, but this also relates to another critique of the Bank: that too often debates about the organisation tend to occur behind closed doors.

The ADB is making a better effort to communicate its strategic direction. The ADB's 2020 Strategy identified three priorities areas: inclusive economic growth, environmentally sustainable growth, and regional integration.[6] The findings of this report indicate that these priorities still resonate with many of the ADB's stakeholders. The Bank is formulating a 2030 Strategy with a particular focus on the United Nations 2030 Agenda for Sustainable Development and the 2015 Paris Agreement to combat climate change.[7] It is looking for ways to partner with other institutions to address the region's infrastructure gap. The Bank is debating whether it will continue to lend to middle-income countries, some of which have become major aid donors in their own right, or 'graduate' them out of their eligibility to borrow from the Bank. In terms of the scope of its work, the ADB has been considering whether it should keep its focus on infrastructure or extend its activities to other development initiatives.

NEW COMPETITION

Today, the ADB has even more reason to make sure its 2030 Strategy resonates with its member countries. In 2015 two new multilateral banks were officially launched to address the region's ongoing need for infrastructure and sustainable development. The Chinese-led Asian Infrastructure Investment Bank (AIIB) has 57 founding members, a capital base of $100 billion, and a mandate to finance regional infrastructure.[8] The New Development Bank (NDB), established by the five BRICS countries of Brazil, Russia, India, China, and South Africa, will also have a capital base of $100 billion.[9]

Both banks are still embryonic and it will be years before their loan portfolios become significant. However, the establishment of the new banks has deepened the debate about established development practices, including the belief among many developing country governments that too many safeguards are slowing down projects. These new institutions are promising faster processes and less red tape. They have also brought into sharper focus resentment from developing countries about the lack of governance reform in the established MDBs. Meanwhile the AIIB, in particular, has been seen as an expression of China's geopolitical ambitions in Asia, linked to its 'Belt and Road' framework promoting regional connectivity through policy coordination, infrastructure, trade, financial integration, and people-to-people ties.[10]

The ADB has signed memoranda of understanding with both new banks, including an agreement to co-finance projects with the AIIB. But even if all of these MDBs, new and old, collaborate and scale up their activities, they will still struggle to meet the huge demand for development in Asia. In 2012 an ADB report estimated that the total investment needed for Asian infrastructure between 2010 and 2020 would be in the order of $8 trillion.[11] This is why the ADB is committing to scale up its annual lending to $20 billion by 2020, with the bold ambition of reaching a 1:1 co-financing ratio, leveraging this amount up to $40 billion.[12]

It is not only competition with new MDBs that poses challenges for the established IFIs such as the ADB. The IFIs were initially designed to mobilise cheap capital from the international financial markets for countries where external finance was not available. Now, recipient countries have access to multiple sources of finance that in many cases dwarf the development finance that IFIs can provide. Some even question whether an increasingly prosperous Asia still needs its own publicly financed development bank.

KEEPING THE ADB RELEVANT

Given the pace of change in Asia and the creation of new development institutions, the ADB will have to keep proving its relevance to donors and borrowers. This report provides background on what the ADB is and does, and identifies three main challenges for the Bank. Chapter 1 examines how the ADB can navigate the geopolitical dynamics of a region squeezed between the United States and a rising China. Chapter 2 explores how the Bank will fulfil its mandate for economic development and poverty reduction while responding to Asia's changing economic geography. Chapter 3 suggests how the ADB can harness alternative methods of development finance to remain an attractive source of finance in the region. In the concluding chapter, some recommendations for the ADB are put forward to strengthen the Bank's standing in the Asian region.

BACKGROUND: WHAT IS THE ASIAN DEVELOPMENT BANK?

The ADB comprises 67 member countries, including 40 developing countries from the Asia-Pacific region.[13] Shareholdings are determined by the amount of ‘subscribed capital’ a country has committed to the ADB’s capital base that it can draw on to help support its lending activities. Because this lending base is leveraged in international financial markets using the Bank’s AAA credit rating, less than 5 per cent of a country’s capital subscription is ever actually paid-in, making the ADB a highly cost-effective way of helping mobilise capital for its members.

Japan and the United States have the dominant shareholder positions, with 15.6 per cent and 15.5 per cent of shareholdings, respectively. While the formal voting structure privileges both the United States and Japan equally, most observers agree that Japan is the senior partner.[14] Every president of the ADB to date has been Japanese and the Bank has close connections with the Japanese Ministry of Finance. The shareholding structure is heavily weighted towards non-borrowing members. Of the borrowing shareholders, China, India, and Indonesia have more ownership of the Bank than other borrowers, although still significantly less influence than either Japan or the United States.

Figure 1: ADB shareholders as at 31 December 2015

Source: ADB website and annual reports

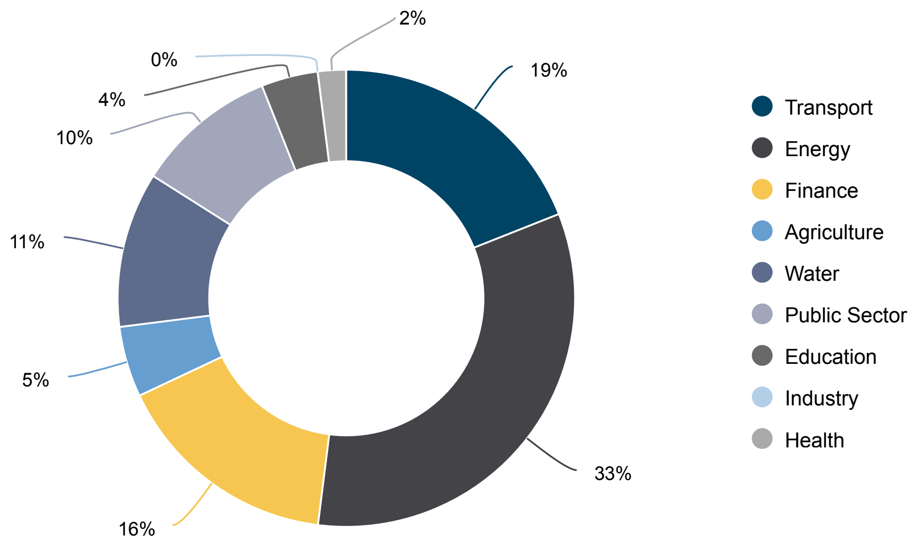
The ADB has several layers of governance at the top of the organisation. The Board of Governors comprises political officials from member states, usually finance ministers or treasurers. The resident board of 12 directors, supported by 12 alternate directors, is made up of political appointees and public servants (eight from Asia and the Pacific and four non-regionals) and represents different groupings of ADB member countries.[15] The directors, who are based in the ADB headquarters, are influential within the Bank and have the final say over the administrative budget and all loans, grants, and equity investments made by the ADB. Directors walk a fine line: they are required to make decisions in the Bank's interests, but also, to varying degrees, reflect the national interests of the countries from which they come. The president is the link between the Bank's management team and the board (of which he[16] is the chairperson). The president is supported by a team of vice presidents. The vice president roles are often distributed among the big shareholders in the Bank and in 2016 were held by US, Chinese, Indian, Australian, Indonesian, and Dutch nationals. None of these tiers of management are selected through an open or competitive process.

OPERATIONAL STRUCTURE

The ADB is a centralised organisation with headquarters in Manila. For a relatively small organisation of approximately 3000 staff, the ADB is stretched across many different areas of geographic and thematic focus. There are departments set up to implement projects and programs in geographical regions (Central and West Asia, East Asia, South Asia, Southeast Asia, and the Pacific) that are supported by country offices called 'resident missions'. The ADB also has seven sector groups (education, energy, finance, health, transport, urban, and water) and eight thematic groups (climate change and disaster risk management, environment, gender equity, governance, public-private partnership, regional cooperation and integration, rural development and food security (agriculture), and social development).

The Bank provides non-concessional and concessional loans, grants, technical assistance, and co-financing. It underlined its importance as a regional actor with its increased lending during the Asian financial crisis (together with the IMF and the World Bank) in the late 1990s. In 2015, the ADB had committed $16 billion in direct lending across 250 projects, with an average project size of around $65 million, and an additional $9 billion was committed from other donors through co-financing.[17] Over the past 50 years, it has contributed $300 billion of development finance to its member countries. The ADB is expected to increase its annual loan commitments to $20 billion by 2020.[18] The ADB continues to maintain a core focus on infrastructure, with almost half of its lending portfolio allocated to energy and transportation infrastructure.

Figure 2: ADB lending by sector in 2015



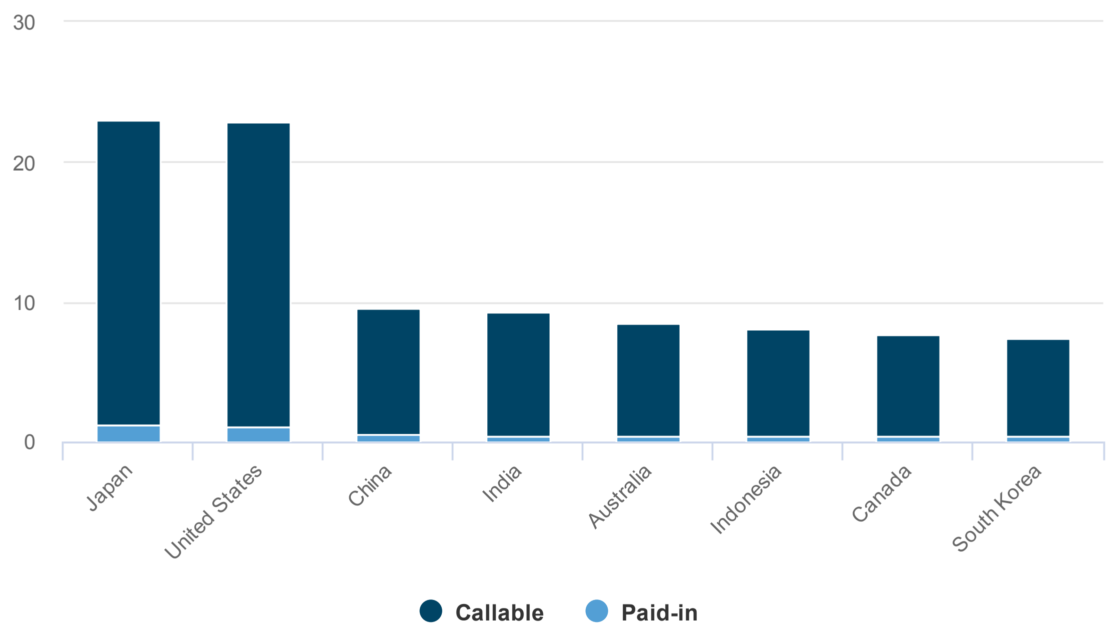
Source: ADB lending database

The ADB has two primary lending arms. It provides market-based non-concessional loans, equity investments, and loan guarantees to middle-income governments and the private sector in developing countries through its ordinary capital resources (OCR). Member nations typically pay in 5 per cent (or less) of their capital subscription to the OCR, which is then leveraged in lending markets. As at 2015, it has an equity base of $19 billion, of which $7.8 billion is paid-in capital (from a subscribed capital base of $153 billion) and $11 billion is in reserves.[19] Currently 23 countries have access to OCR.

The ADB's other lending arm, the Asian Development Fund (ADF), provides concessional loans and grants to low-income governments at below market rates. The ADF is currently not leveraged through international lending markets and as such must be replenished every four years by both donors and internal contributions from the ADB. To date, the ADF has gone through 12 replenishment rounds totalling $55 billion (inflation adjusted), of which half has come from member countries and the other half through profits gained from the Bank's non-concessional lending. Japan has contributed roughly 50 per cent of all ADF funds in the past 50 years. Currently, 29 countries have access to the ADF, 17 of which have exclusive access and have not achieved a level of development that qualifies them for OCR loans. The remaining 12 can access both OCR and ADF loans.

By leveraging the majority of its lending capacity through financial markets, the ADB is an incredibly cheap public financial lending institution for its member countries. In 1968, the Bank's first year of lending activities, members paid in 30 per cent of committed OCR, with the remainder drawn down from lending markets. A decade later, paid-in resources had dropped to 16 per cent. Today, member countries pay in less than 5 per cent of their capital subscriptions. The remainder is retained by member countries as callable shares. The ADB has only needed five capital increases in its lifetime and has never required any additional payments from its members. It has turned marginal investment from member countries into $228 billion (inflation adjusted) of lending over 50 years. The high returns from relatively marginal investments is a major advantage to this IFI model.

Figure 3: Paid-in vs callable shares of OCR for top 10 ADB members, 2015 (%)



Source: 2015 ADB financial report

Figure 4: Total ADF contributions from member states and internal resources, 1968–2015

Notes: Figures for ADF replenishments I–V were sourced from the ADB's 1990 Annual Report; 1990 is therefore the year taken to adjust for inflation for all ADF contributions before this point, understating the overall difference between real and nominal ADF contributions

Source: ADF replenishment documents

In 2017, the ADB will merge the OCR and ADF, combining concessional and non-concessional lending in order to increase lending capacity and liquidity.[20] By merging the two lending arms of the Bank, the ADB will be able to increase lending to poor countries by up to 70 per cent.[21] However, this will also increase pressure on the ADB to approve new loans and to create a pipeline of 'bankable' projects. The Bank also places particular emphasis on co-financing projects and hopes to hit a target of a 1:1 ratio of co-financing to lending by 2020.[22] In 2015, lending to the private sector made up 16 per cent of total bank lending.[23] These are ambitious plans.

CHAPTER 1

THE GEOPOLITICAL CONTEXT

Since the end of the Second World War, the United States has played a prominent role in the economic development and security of the Asia-Pacific region. It has done so primarily through its strategic alliances with key regional countries such as Japan and Australia, but also through its leadership of international institutions, such as the ADB. During the 50 years of the ADB's history, parts of East Asia have grown remarkably but the greatest economic transformation has been in China, which has been the world's fastest-growing economy since the 1980s.[24] The rise of China is changing the economic and strategic landscape of Asia, not least in the field of development.

China has become a significant new ADF donor but it is also promoting alternative approaches to development to the established IFIs. It has placed particular emphasis on physical infrastructure and GDP growth, without the high social and environmental standards of the IFIs. It has talked of the need to respect sovereignty ('no strings attached'), and about the mutual benefits of aid in its so-called 'win-win' approach to development.[25] Many of China's neighbours are wary about bilateral Chinese investment through its opaque state-owned policy banks and are suspicious about China exporting excess economic capacity. China's bilateral aid is criticised for its lack of transparency and failing to adhere to fiduciary, environmental, and social standards.[26] Some regional countries fear that China does expect political concessions in return for its development assistance, and that more broadly its goal is to use new institutions such as the AIIB as vehicles for its influence.

When Japan started to rebuild its post-war economy in the 1960s, its neighbours were also wary of its rising influence. Japan used the multilateral ADB to invest in its neighbours because it would be seen as a more neutral channel. Compared with bilateral aid, the appeal of the MDBs for donors has always been their reputation for political neutrality, freedom from special interests and corruption, technical professionalism, long-term development perspective, and hands-on program design and finance engagement.[27] But the supposed neutrality of the MDBs is being challenged by the creation of new MDBs in a different mould.

China is taking a similar approach to that pursued by Japan in the 1960s, but with a much more ambitious scope. In addition to its creation of the AIIB, it hosts the headquarters of the BRICS NDB in Shanghai, has proposed the creation of a development bank for the Shanghai Cooperation Organisation, and has launched the Silk Road equity finance fund.[28] All of this has occurred while the region's traditional Western donor countries have been recovering from the 2008 global financial crisis, which caused many of them to reduce their aid budgets. In particular, the ADB's European members have been preoccupied with instability in Ukraine and Greece, and questions have been raised about the future of the European Union in the wake of Brexit.

China's growing role as a regional development actor has been closely watched by the United States. Indeed, the nature and quality of US–China relations over coming years will play a major role in shaping the regional development agenda and the environment within which the ADB will operate. The ADB's work underpins peaceful regional cooperation and economic prosperity in Asia. So far, both the United States and China have been supportive of the Bank's work. But should the US–China relationship deteriorate into one characterised by more overt geostrategic competition, the grounds for cooperation will narrow. An additional degree of unpredictability has been injected into the relationship by the election of Donald Trump, an avowed protectionist and economic nationalist, as US president.

The effect of geopolitics on the development landscape could result in two camps forming: the new multilateral banks led by China, with faster processes and fewer safeguards, competing with the traditional development banks such as the ADB, with slower processes and higher standards. Part of the challenge for the ADB is that its two major shareholders have not joined either of the new multilateral banks. The 'two camps' scenario depends on the new banks being able to successfully introduce new models of development banking (which remains to be seen) and supposes that the established MDBs are not evolving. It is clear that cooperation between the old and new banks would lead to better development outcomes in the region.

This chapter will explore how the changing geopolitical dynamics of Asia will set the parameters within which the ADB will need to operate in coming decades. In particular, it will focus on emerging ADF donors, namely China and India, and their involvement with the ADB as well as with the new MDBs. These perspectives are compared with those of the traditional and largest ADF donors including Japan, the United States, Australia, and the European countries (the latter are treated as a bloc because of their influence in the Bank when they vote together). The attitudes of these major donors will shape the future of the ADB and the Bank will need to keep engaging emerging donors. Other country perspectives will be explored in more detail in Chapter 2.

GEOPOLITICS IN THE ASIA-PACIFIC

The geopolitical context in which the ADB must operate has grown more complicated as the relationship between China and the United States has become more difficult. The US–China relationship is still far from the levels of mistrust that marked the US relationship with the Soviet Union during the Cold War. But while there remain clear areas of cooperation between Washington and Beijing, there are also growing areas of competition and tension. By all present indications, these are likely to increase in coming years.

China's foreign policy objectives have clearly shifted under the leadership of President Xi Jinping. Former leader Deng Xiaoping's famous dictum of 'hide your strength, bide your time' has been replaced by a new more assertive vision pursued by Xi for a "great rejuvenation of the Chinese nation".[29] While the nature of that rejuvenation is hotly debated, even in China, Xi is very clear that this involves China being treated with the deference that befits a great power. Under Xi, China has become more confident about challenging the status quo, even at the risk of aggravating its neighbours. In terms of development and regional economic governance, China is becoming more of a 'rule-maker' than a 'rule-taker'.

China's interest in new rules comes at a time when the 'liberal world order' consensus of Western developed countries is under pressure. The global financial crisis undermined confidence in the strength of developed economies and unsuccessful interventions in the Middle East have led to suggestions of US overreach. The election of Donald Trump has, at the time of writing, added new uncertainties to questions about the US role in the world. At least in part, Trump was elected to office on a platform of economic protectionism and nationalism. During the campaign he seemed at times to show admiration for one-party rule in China (and Russia) while at the same time threatening a trade war with Beijing.

Trump's election has deepened concerns about whether the Obama administration's 'rebalance to Asia' will ever be fully realised. President Trump's first act was to withdraw from the Trans-Pacific Partnership (TPP), the economic centrepiece of the rebalance, which attempted to "write the rules" for trade and investment among key US allies and partners in the Asia-Pacific region.[30] While some efforts to resuscitate the TPP in another form are being discussed, its demise will affect the credibility of the US commitment to Asia.

On the other hand, Xi's new assertiveness has not been an unqualified success for China. Xi has stood up for what he claims are China's rights in the South China Sea and elsewhere, and has launched a sweeping new vision for Chinese-led economic development in the region in the form of the 'Belt and Road' initiative. While some Asian countries are keen to attract new Chinese investment, others have become more wary of Chinese intentions as reflected in its military activities in the South China Sea. Asian middle powers and developing countries are trying to manage a delicate balance between their old security ally and new economic partner.

The character of the US–China relationship is not the only factor that will shape the geopolitics of Asia, even if it is the crucial one. The role played by other major Asian powers, most notably Japan and India, will also be important. To differing degrees, both are as worried about the uncertainties regarding the US role in Asia as they are about China's rising assertiveness. Both are also important economic, strategic, and development actors in their own right and will also play a key role in shaping the environment in which the ADB must operate in coming decades.

NEW GEOPOLITICS OF DEVELOPMENT

New forms of rivalry and cooperation between Asia's big powers are also affecting the emerging geopolitics of development. Developing countries in Asia have sometimes been critical of the so-called 'Washington consensus' model of development.[31] The harsh treatment meted out by the IMF in the wake of the 1997 Asian financial crisis is still remembered by a number of regional governments and has contributed to some reluctance to borrow from IFIs and cynicism about their advice.[32] Against this background, new donors led by China are proposing alternative development paths and 'South-South cooperation' whereby developing countries help each other and share experiences. The South-South rhetoric has taken on new significance with the creation of two new multilateral banks — the AIIB and the NDB — now operating in Asia and led by non-traditional donors.

Part of the appeal of South-South cooperation comes from frustration with slow reforms in the established financial institutions. In 2010, the World Bank and the IMF underwent a series of governance reforms to give more voice to emerging markets. The IMF reforms were stalled in the US Congress (the United States has veto power in the Fund) until 2015 when they were passed to shift quota share from advanced economies to emerging markets by 2.8 per cent.[33] The World Bank reforms for the International Bank for Reconstruction and Development increased the collective vote of developing countries by an aggregate 4.6 per cent in 2010 compared with 2008.[34] Emerging markets are still under-represented, particularly China and India (see Table 1).

Table 1: Voting influence within multilateral banks in Asia as at 2016 (%)

	China	India	Japan	United States	Australia
ADB	5.5	5.4	12.8	12.7	4.9
World Bank (IBRD)	4.6	3.0	7.2	16.5	1.4
AIIB	26	7.5	–	–	3.5
NDB	20	20	–	–	–

Sources: ADB, *Annual Report 2015*; Scott Morris and Mamoru Higashikokubaru, “Doing the Math on AIIB Governance”, CGD (blog), 2 July 2015; World Bank, “International Bank for Reconstruction and Development Subscriptions and Voting Power of Member Countries”, 4 October 2016

The development landscape has changed considerably in a short period of time. A 2007 eminent persons report commissioned by the ADB when designing their 2020 Strategy concluded that “as the only multilateral development bank in Asia, ADB is well-placed to assist the region in meeting the many conceptual, technical, and institutional challenges in pursuing regional integration”.[35] Just a decade later, the ADB now has new collaborators such as the AIIB and NDB to meet these challenges.

The AIIB has 57 founding members, authorised capital of $100 billion, and a mandate to foster economic growth by financing regional infrastructure. In 2016, the AIIB announced four project loans: one stand-alone operation in Bangladesh and three co-financed projects with the ADB, European Bank for Reconstruction and Development, and the World Bank.[36] The diversity of the AIIB membership came as a surprise to China, and it will have to manage deftly the different interests of its members. Key US allies in Asia, notably Australia and South Korea, are founding members. Even Canada applied for membership in 2016 and will be part of the next round of AIIB members to be confirmed in 2017.[37] No Pacific Island countries are currently part of the AIIB but they could be on the list of 30 unknown countries waiting to join.[38] Japan and the United States are not AIIB members.

While the AIIB is still evolving, there are significant points of difference between the AIIB and the ADB in membership, mandate, and board structure. China has veto power over all majority decisions in the AIIB.[39] To establish its credibility as a neutral multilateral actor, the AIIB will have to prove it is making decisions independently from the Chinese Ministry of Finance. The AIIB president has a lot of influence thanks to a non-resident board which reinforces the perception that “the AIIB will be much more centrally controlled by the Chinese government than is the case with the largest shareholder in other MDBs”.[40] In a positive step, the AIIB articles of agreement emphasise economic criteria as a basis for deciding projects (as opposed to serving political interests) and the new bank has already recruited international staff.[41] The AIIB is also emphasising its similarities with the Bretton Woods MDBs, with President Jin Liqun stating that the AIIB is “part of the MDB family”.[42] But the Australian Government claims the AIIB is “not a development bank in the style of the World Bank Group or the Asian Development Bank although it has been designed to complement the work of both organisations”.[43]

The NDB (also known as the ‘BRICS bank’) is an initiative of Brazil, Russia, India, China, and South Africa. All five countries are founding members and have equal share in the bank. Unlike the AIIB, the NDB has had trouble establishing itself. This is partly because of the differences in economic performance between the founding countries, questions about leadership, and concerns about the NDB’s credit rating. The NDB has a broad mandate for infrastructure and sustainable development but is currently only focusing on development projects within the five founding members. It wants to issue loans in local currencies and use country standards, and has already released green bonds in renminbi.[44]

There are some scenarios where there could be competition between the old and new MDBs. For example, there could be cases where the ADB does the groundwork for a project with another bank coming in with better terms towards the end of the project. Alternatively, banks could be forced to bid against each other for projects. Another area of potential tension is the AIIB recruiting staff from the World Bank and ADB. Despite these concerns, the ADB has reacted positively to the emergence of these potential competitors. This is because the ADB realises that the new banks could be good complements to it, rather than replacements. There are also clear benefits from greater MDB cooperation, for example there are already efforts to align all the MDBs to better resource the UN Sustainable Development Goals.

The ADB has signed memoranda of understanding with both new banks. The ADB–AIIB agreement was signed on the sidelines of the ADB’s 2016 annual meeting while the NDB president visited the ADB headquarters in Manila two months later to sign the ADB–NDB agreement. In many respects, the ADB has little to fear from the AIIB and the NDB. The ADB has a long history (of both successes and failures), high standards, and a development focus on poverty that the new banks do not.

ASIA'S NEW ECONOMIC GIANTS: CHINA AND INDIA IN THE ADB

For the ADB, the emergence of potential competitor institutions is not the only significant factor in the changing geopolitics of development. Another important question is how the big emerging economic players, China and India, choose to engage with the ADB in the future. The ADB offers China and India the opportunity to play constructive regional roles. Both are already significant economies that do not follow the OECD Development Assistance Committee model of development and instead are proponents of South-South cooperation when it suits their interests. Both countries are also developing their own approaches to regional governance.

CHINA

China's interest in development and economic governance is driven by several considerations: its transition from an investment to consumption driven economy (and the problem of excess heavy industry); its concerns about instability in its immediate neighbourhood; and its desire to demonstrate regional leadership and political clout.[45] China's new Belt and Road framework is still a nebulous concept for regional connectivity with the overall intention of linking Europe to China across Eurasia and the Indian Ocean.[46] Different messages about the motivations for Belt and Road have emerged. In China, some say the initiative is "China's external development strategy" while others promote it as an altruistic regional project for many countries to be involved in.[47] The AIIB is understood to be one of the possible financing vehicles for projects within the Belt and Road framework. It is not yet clear, however, what role the ADB could have in the initiative.

China has had a long and fruitful relationship with the ADB since it joined the Bank in 1986. It is the third-largest recipient of ADB lending in the Bank's history (behind India and Indonesia), having received some $34 billion over 30 years.[48] According to an ADB Country Director for China, ADB and World Bank personnel have built strong relationships with Chinese officials, and are able to give advice on policy issues in a way that a foreign government cannot.[49] The new ADB–China country partnership strategy for 2016–2020 outlines new areas for cooperation in climate change management, sustainable development, and private sector lending.[50]

Apart from being a major recipient of ADB funding, China is also playing an increasingly important role in the Bank's governance. China has the third-largest voting share of 5.5 per cent in the ADB, although this is still less than half of the share of either the United States or Japan. At the board level, China is pushing for better knowledge and skills transfer to be a priority for the Bank. As a Chinese Ministry of Finance official noted, while China is still learning from the MDBs, it thinks it has its own knowledge to offer: "China is interested in a two-way knowledge transfer. Other [ADB] borrowers would like to learn more about China's story."[51] China's Regional Cooperation and Poverty Reduction Fund is the first and only ADB trust fund established by a developing member country and has supported 64 ADB-approved projects worth $30.2 million from 2005 to 2015; however, China could still contribute a lot more.[52] China's contribution to the ADF increased substantially in the most recent replenishment round; however, its contribution is still low in relation to its economic weight.[53]

Keeping China engaged will be a challenge for the ADB's board and management. Some Bank members, led by the United States, are encouraging China to graduate from developing country status, so that it will no longer have access to non-concessional lending. While China may no longer need the ADB to finance large infrastructure projects, it still has long-term development challenges (discussed in Chapter 2), which make the discussion of China 'graduating' from the Bank premature.

In many respects, more important than the question of whether China should graduate from the Bank, is how China could make increased financial contribution to it. China has much to gain from active membership of the ADB. China cares about its role and status as a regional actor, and this means being an active participant in important regional institutions such as the ADB. Supporting the ADB could also help China to counteract those who criticise it for acting unilaterally and throwing its weight around within the region. But it will also be difficult to encourage China to contribute more to the ADB while its voting share in the Bank's governance remains at current levels. It is perhaps in this regard alone that the AIIB, where China has a 26 per cent share of the vote, might prove to be serious competition for the ADB.

INDIA

India is the largest recipient of ADB lending in the Bank's history. Like China, however, it is at something of a development crossroads, which affects its relationship with the Bank. By the ADB's own economic forecasts, India is the fastest-growing country in Asia.[54] As China's growth cools, it is likely that India will continue to attract investment; however, India also has the largest number of poor people in Asia. With 270 million Indians living in extreme poverty in 2012, India still has serious development challenges.[55]

Along with Japan and China, India is one of the ADB's most influential regional members. India also has the second-highest voting share in the AIIB, albeit with a third of China's voice. In some respects, it shares with China a desire to promote new approaches to development. India has long been a proponent of South-South cooperation, and this has translated into strong support of the BRICS forum and the NDB, which is led by an Indian national, former private banker KV Kamath. Like China, India has its own development 'story' to tell, with a particular post-colonial context.

But India's wariness of China also has an impact on its approach to economic governance and development, which in any event is less coherent than that articulated by China. This is evident in its approach to development projects in its own neighbourhood, where relations are strained. India is not opposed to partnering with China as part of the Belt and Road initiative, but has concerns about China's growing influence and has reacted strongly against the deepening China–Pakistan relationship.[56] Partly in response to Chinese influence, India has been increasing its aid to neighbours, for example it has long been the major donor to Bhutan which is wedged between Chinese and Indian borders.[57]

Nearly a third of ADB lending (by volume) is already in South Asia and there is a lot of scope for the ADB to facilitate regional connectivity as a neutral alternative to bilateral Chinese and Indian investment. Like China, India stands to benefit from engaging in the ADB as an effective regional forum promoting prosperity and helping to deepen its own development relations with its neighbours.

TRADITIONAL DONORS IN THE ADB

The ADB is different from the other Bretton Woods MDBs in having two equally dominant shareholders. The backbone of the ADB remains the partnership between Japan and the United States, with 12.7 and 12.8 per cent voting share, respectively, meaning either country can veto any loan decision. Both countries have provided the resources and intellectual framework for the bank, and have been supported by the Bank's founding members, including Australia and a selection of European countries. Japan runs the Bank while the United States has provided a legitimising force for the ADB by bringing it into the Bretton Woods tent. As neither country is a member of the AIIB or NDB, they will be under pressure to ensure the ADB remains relevant to borrowing countries, and also that it cooperates with the new banks.

JAPAN

Japan remains at the core of the ADB's outlook and operations. As well as the president of the ADB, many senior staff at the Bank are also Japanese, and Japan provides 50 per cent of the Bank's concessional financing, which must be paid-in in hard currency unlike the non-concessional arm.[58] The ADB remains one of the most intimate and intricate of Japan's international relationships.[59] The challenge for Japan is balancing its leadership role in the ADB with giving more voice to other key Asian donors.

The Japanese leadership has underpinned the success of the ADB. There is currently no country in the region which is prepared to provide the amount of financial support to the ADB that Japan has provided. This means that moving away from Japanese influence could have financial consequences for the ADB. Japan has also promoted the ADB as an Asian cooperative and the Bank has lived up to its reputation as an 'Asian bank with Asian values', largely through the prevalence of a Japanese and East Asian organisational culture.[60]

The key issue for the ADB is whether Japan would be prepared to step away from leadership in the future. It is unlikely that the Japanese Ministry of Finance will give up the role of ADB president to a non-Japanese national (just as the World Bank is led by an American and the IMF by a European). This inclination to keep a close hold over the leadership of the ADB will only have been reinforced by the fact that the AIIB is led by a Chinese national. But in the longer term, it would help the ADB to demonstrate it is truly a multilateral bank of the region if the Board eventually elects a president from a different nationality.

The Japanese commitment to high standards in development is an asset to the ADB. Japan's approach to the Bank reflects and is consistent with the way it conducts its foreign policy and bilateral development assistance. As one observer has argued, Japan knows that it will never be able to provide as much development assistance as China does, so it focuses instead on the quality of that assistance. And while Japan's official development assistance (ODA) programs, like China's, do prioritise their own companies for providing assistance, they also try to be focused on the needs of recipient countries.[61]

Japan and the United States have worked together closely in the ADB, but one area of tension has been their differing views on the relationship between the ADB and China. The United States is reluctant for the ADB to keep providing loans to China as it gets richer while Japan recognises that lending to China is profitable for the ADB (discussed more in Chapter 3).[62] At the same time, the current ADB president has nurtured good relations with China and its new AIIB, even though Japan has not joined the new bank as a shareholder. Within Japan, there has been considerable debate about whether to join the AIIB and the original preference of the United States was for Japan not to do so.[63] These positions are not fixed and the United States has become more accepting of the AIIB, making cooperation between the two regional banks more tenable.

In the current geopolitical environment, Japan's greatest test as the country with arguably the most influence within the ADB will be promoting MDB cooperation and preventing the fragmentation of development projects in the region. Japan will also have to defend the standards that the ADB has developed over time, while still promoting governance reform within the Bank and encouraging contributions from other regional members.

THE UNITED STATES

The ADB has been a relatively low priority for Washington, symbolised by its small representative office in the US capital which is dwarfed by the headquarters of the World Bank and the IMF. In the 1980s and 1990s, there were differences within the Bank between the United States and East Asian member countries over the appropriate development model for the region.[64] The ADB leadership was frustrated by the US Treasury's unwillingness to increase their contribution in the mid-1990s and this led some to conclude there was "a general waning of interest in the [ADB] by the United States".[65]

In more recent years the relationship has improved, partly as a result of reforms undertaken by the Bank that are supported by the United States, for example extending into more innovative financing.[66] This has also corresponded with a less negative US stance on replenishments and capital increases. Nevertheless, the ADB does not appear to have figured prominently in the US rebalance to Asia under the Obama administration.[67] The attitude of the Trump administration is even less clear, as are the outlines of US policy in Asia more generally.

In some respects, the emergence of the AIIB might mean that the ADB will become more prominent in US policy towards Asia. The United States declined to join the AIIB and was hoping that many of its allies in the region would similarly abstain. There has been considerable speculation about why the United States responded in the way it did. Many commentators agree that the rejection of the new bank was driven by the concern that "Beijing's approach to rule making is likely be at odds with US interests".[68] On the other hand, the United States may not have expected the proposal to get off the ground, reflecting a lack of understanding of Asian governments' desire and need for infrastructure.[69] Given the initial strong stance against the new bank, it is unlikely the United States will join the AIIB in the short term, even if it might be the best way to influence governance and standards.[70] Because the United States is not part of the AIIB, there is naturally more incentive for it to support the role of the ADB in the region.

Using the ADB as a geopolitical tool could do more harm than good given the delicate US–China relationship. There are concerns among some countries (both developing and developed) that existing US influence in MDBs has enabled it to use them and other IFIs as instruments of US foreign policy. Even though the United States has played a relatively 'hands off' leadership role in the ADB, its dominant shareholding position means it still has a lot of influence in swaying reforms in the ADB. Changes to the ADB governance structure can only come about through a capital increase or the addition of new members, both requiring sign-off from the United States. It is unclear how the United States would respond to either of these actions, although the former is unlikely to be necessary in the short term given the recent merger of the capital base which has increased the Bank's lending capacity. In the meantime, it would be in the US interest to continue to support the ADB's work and promote the Bank's merits in the region.

AUSTRALIA

The Australian Government refers to the ADB as the "principal international development finance institution for the Asia-Pacific region".[71] Australia holds a unique position in the ADB, both as a Western OECD donor but also a regional member. Australia values the influence it has in the ADB (it has a much smaller say in the other MDBs) and has its own interests, including promoting a greater role for the private sector in the Bank's work, and emphasising a focus on the Pacific Island countries. Australia has been the second-largest contributor to the ADF in the last two replenishment rounds and has followed through on its financial commitments.[72]

However, given the decline in the Australian aid budget since 2013, Australia could play a lesser role in the future of the Bank. Australia can leverage its position in the ADB by continuing to provide development knowledge and constructive ideas for reform (e.g. improving the Bank's policy advice) but its influence could decline if its financial contribution decreases. Some Australian officials are sympathetic to giving more voice to regional members and this could be a positive force for governance reform in the bank.

THE EUROPEANS

The 17 European ADF donors each alone have a relatively small say in the ADB, but together they make up 17 per cent of voting power in the Bank.[73] As a bloc, this is a significant grouping. However, many of the European countries face austerity constraints and their governments are preoccupied by the economic volatility in their own region. Recently, it has been more difficult for the ADB to engage with some of these countries. Despite this, a 2014 report from the Netherlands Institute of International Relations called on European governments to strengthen their engagement with the ADB because they "stand to benefit from deeper cooperation and integration in the region".[74]

Historically, some of the European donors have offered the Bank important development perspectives and introduced positive cultural changes, for example a focus on gender equality. Unlike the United States and Japan, many of the European donors have joined the AIIB and "many European countries thought they needed the AIIB as a means of engagement with

China more than China needed them to establish the bank".[75] As the European countries seek to establish new linkages with China and Chinese institutions, they must take care not to erode support for the original multilateral institutions that they helped to establish.

CONCLUSION

China's shift in foreign policy and promotion of an alternative development model creates new challenges for the ADB. There is concern about two camps forming: the new multilateral banks led by China, with faster processes and fewer safeguards, competing with the traditional development banks such as the ADB, with slower processes and higher standards. The ADB's neutrality is more important than ever when there is a risk that its major shareholders will be driven by their national interests rather than what is best for the Bank. For example, the United States wanting China to graduate, China wanting the Bank to diversify away from infrastructure and poverty, and a Japanese monopoly on the Bank's leadership. At the same time, some ADB members face declining aid budgets meaning they could be less willing to contribute to the Bank in the future. Slow reforms in the established multilateral organisations mean that South-South cooperation is more appealing for some of the ADB developing member countries. In this context, the ADB needs to keep large regional members such as China and India engaged, while maintaining its high standards.

CHAPTER 2

ASIA'S NEW ECONOMIC GEOGRAPHY

Contemporary Asia is a vivid result of dynamic economic and social processes, which have seen the region achieve the fastest rates of economic growth in the world. The IMF has forecast that Asia's economy will be larger than that of the United States and European Union combined in less than two decades.[76] Already, the region accounts for around 40 per cent of global GDP. Some 60 per cent of the world's population lives in the region and by 2030 it will be home to 66 per cent of the global middle class.[77]

These statistics are very impressive. However, they obscure the significant sub-regional and national differences of the region. Much has been written about China's success at lifting 800 million people out of poverty since initiating market reforms in 1978, but this has only been a partial success. The reality of poverty in Asia is sobering: almost half of the world's extremely poor people (326 million out of a global total of 766 million) live in South and East Asia.[78]

This chapter looks at the economic changes that have occurred in Asia and identifies the major challenges confronting the region that are relevant to the ADB's mission as the region's development bank. It argues that despite the phenomenal economic progress made across parts of the Asian region over the past 30 years, Asia continues to face major challenges in overcoming extensive extreme poverty and growing inequality, often within the borders of increasingly prosperous countries. Addressing this double dilemma is core to the Bank's development mandate. However, stumbling blocks to development include the extent of the region's infrastructure gap, the impact of climate change, and the effects on the environment of the dramatic industrialisation which has fuelled the economic progress.

At the same time, the Bank needs to factor in the tectonic demographic shift underway across the region as its populations age and shift to urban centres. However, as we have seen in Chapter 1, the Bank is a collection of member states with various agendas for the Bank, influenced by the region's geopolitical reality. It is under their influence that the Bank is steered in any one direction. This chapter concludes by looking at the expectations of shareholders and stakeholders and what they think the Bank should do to remain relevant to the region.

THE CHANGING ECONOMIC LANDSCAPE

Most of Asia's developing countries, which are also members of the ADB, are now middle-income countries. However, this categorisation can be misleading. Table 2 shows that the majority of the ADB's Asian developing member countries are still in the lower middle-income category with a further two — Afghanistan and Nepal — designated as low-income countries. This means that 17 of the ADB's developing member countries have an average gross national income (GNI) per person of around $4000 or less, while Afghanistan and Nepal's annual GNI per capita is less than $1025. This stands in stark contrast to an OECD GNI average of around $38 720 per person. Even China exemplifies the stark differences between Asia's success stories and OECD realities. Although now hailed as the second most powerful economy in the world after the United States, and despite having four times the US population, China's GDP in 2015 was $10.866 trillion compared with the US economy of $17.947 trillion.[79]

Table 2: Asia's developing countries by income category as at July 2016

Low-income **GNI pp/pa $1025 or less**	**Lower middle-income** **GNI pp/pa $1026 to $4035**	**Upper middle-income** **GNI pp/pa $4036 to $12 475**
Afghanistan	Armenia	Azerbaijan
Nepal	Bangladesh	China
	Bhutan	Georgia (upper first year)
	Cambodia (first year)	Kazakhstan
	India	Malaysia
	Indonesia	Maldives
	Kyrgyz Republic	Thailand
	Lao PDR	Turkmenistan
	Mongolia (first year)	
	Myanmar	
	Pakistan	
	Philippines	
	Sri Lanka	
	Tajikistan	
	Timor-Leste	
	Uzbekistan	
	Vietnam	

Source: World Bank Country and Lending Groups, July 2016, http://data.worldbank.org/about/country-and-lending-groups

Another indicator of the significant variations in economic and social development progress across developing member countries can be seen in Table 3. The Human Development Index (HDI) ranking of several developing members as well as the percentages of respective populations below the poverty line highlight the acute variations.[80] Furthermore, Afghanistan, a low-income country, and Myanmar, a lower middle-income country, are among the 11 developing member states on the ADB's list of fragile and conflict-affected states, the other nine being in the Pacific although Timor-Leste is only slightly above the cut-off point for inclusion on the list. States considered to be in fragile situations are those which, according to the OECD, have weak capacity to carry out basic governance functions, are unable to establish constructive working relations with its own society, and are vulnerable to internal and external shocks whether economic crises or natural disasters.

Table 3: Comparative GDP per capita and HDI indices for ADB developing member countries

Country	GDP per capita (constant 2010 US$)[81]		GDP per capita (current US$)[82]	HDI score[83]		HDI ranking[84]	population below poverty line (%)[85]
	2000	2014	2014	2000	2014	2014	2014
Afghanistan	–	406		.334	.465	171	39.1
Armenia	895	2362		.648	.733	85	30.0
Azerbaijan	874	3276	7,884	.640	.744	78	5.0
Bangladesh	412	747	1,086	.468	.570	142	31.5
Bhutan	991	2056	2,560	–	.605	132	12.0
Cambodia	330	749	1,094	.419	.555	143	13.5
China	1127	3862	7,590	.588	.727	90	7.2
Georgia	1018	2724	3,670	.672	.754	76	21.4
India	572	1233	1,581	.496	.609	130	21.9
Indonesia	1072	1853	3,491	.606	.684	110	11.2
Kazakhstan	2343	5580	12,601	.679	.788	56	2.8
Kyrgyz Rep	417	637	1,269	.593	.655	120	30.6
Lao PDR	378	818	1,793	.462	.575	141	23.2
Malaysia	4861	7365	11,307	.723	.779	60	0.6
Maldives	–	5221	7,635	.603	.706	104	15.0
Mongolia	768	1882	4,129	.589	.727	90	21.6
Myanmar	–	–		.425	.538	148	25.6
Nepal	289	426	701	.451	.548	146	25.2
Pakistan	620	813	1,316	.444	.538	147	12.4
Philippines	1056	1662	2,872	.623	.668	115	25.2
Sri Lanka	1051	2045	3,819	.679	.757	74	6.7
Timor-Leste	511	769		.468	.595	133	49.9
Tajikistan	234	507	1,114	.535	.624	129	32.0
Thailand	2316	3768	5,977	.648	.726	93	10.9
Turkmenistan	1404	3873	9,031	–	.688	109	–

Uzbekistan	446	959	2,036	.594	.675	114	13.7
Vietnam	531	1077	2,052	.575	.666	116	8.4

Sources: ADB's 2014 poverty percentages (looking at the changes between 2000 and 2014); United Nations Development Programme Human Development Indices; World Bank GDP per capita figures

BOX A: DOING THINGS DIFFERENTLY IN THE PACIFIC

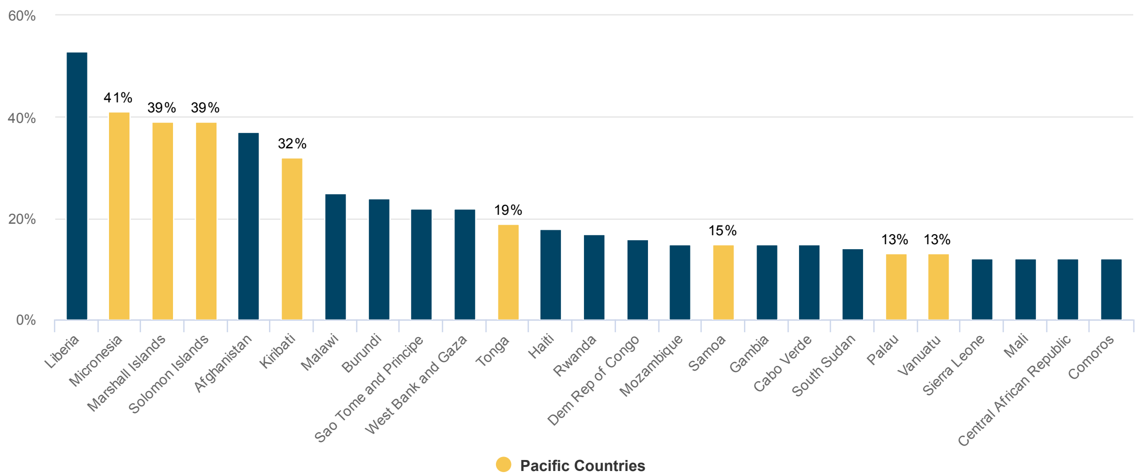
As outlined in the Project Approach, the Pacific region is not within the scope of this report. Most Pacific Island countries are low income and face a unique set of development challenges. Disadvantaged by remoteness from major markets, small market size, weak governance, exposure to the threats of natural disaster and climate change, and rapidly growing populations, it is a region of the world that must be engaged with in new and different ways. It is also a region that cannot and should not be ignored by the Bank; 13 Pacific countries are ADB members and make up more than one-third of the countries that receive funding from the Bank.

However, it is easy to understand how the Pacific can be overlooked. The voting power of the Pacific members of the Bank, when taken as a group, is only 4 per cent, less than that of Australia. The region makes up only 1 per cent of the population of the countries that received concessional loans in 2015 and accounted for less than 3 per cent of total Bank concessional lending over the past 15 years.[86] Despite the Pacific's limited relevance to the Bank's overall financial operations, it is a region where development challenges are among the most acute and the Bank has the potential to have significant impact.

The ADB is already a major player in development finance in the Pacific region, the fifth largest in 2013.[87] Between 2000 and 2013, approved concessional lending from the Bank accounted for 6 per cent of all ODA to the Pacific. Over the same period, however, the Bank's concessional lending to all of its recipient members accounted for 11 per cent of total ODA to those countries. Clearly there is room for increased commitments of development financing to the Pacific within the confines of absorptive capacity and avoiding debt distress. The ADB has already made solid ground here by committing to more than doubling its loans and grants across the Pacific over the next five years.[88]

In one of the most aid-dependent regions in the world — eight of the world's top 25 aid-dependent countries are in the Pacific[89] — increasing the volume of development financing alone will not be enough for the ADB to have a significant role in the region that it should be aspiring to.

Figure 5: Aid as a share of GNI of top 25 aid-dependent nations, 2011–2013 average



Source: World Bank Databank

While infrastructure will be an important element of development finance to the region, the Bank should also consider focusing its efforts in more concentrated ways around a few areas that show true promise in the Pacific, including labour mobility schemes, fisheries management, integrating Information Communication Technologies, and regional integration. Equally as important is the need for expertise and technical capacity, which is critically lacking in the region. To that end, the ADB could also consider shifting more of its Manila-based staff to offices in the region.

What is clear is that more work needs to be undertaken to look at improving the ADB's engagement in the Pacific. To complement the ADB's 2016–2020 Pacific Approach, the Bank should commission an independent assessment of their engagement across the region.

ASIA'S MAJOR DEVELOPMENT CHALLENGES RELEVANT TO THE ADB'S MISSION

Notwithstanding the varying degrees of economic success enjoyed by different countries across developing Asia, all share a number of key challenges. There are three issues in particular that the ADB is well placed to address: poverty and inequality; a yawning infrastructure gap and the need for greater connectivity; and the impact of climate change. All three issues were singled out in the ADB's 2020 Strategy. A mid-term review of the 2020 Strategy in April 2014 reinforced the significance of these regional challenges.[90]

However, these are not the only major issues affecting Asia's development. The authors' discussions with ADB stakeholders and other development experts identified two other major challenges: the shift in the region's demographics both in terms of its ageing population and growth in urbanisation; and the disappointingly slow pace of economic growth in a number of middle-income countries (sometimes described as the 'middle-income trap').

How the ADB responds to these challenges will be important measures of the Bank's continuing relevance to the development agenda in Asia over coming decades.

REDUCING POVERTY AND ACHIEVING INCLUSIVE GROWTH

Asia's success in reducing poverty has been well documented and celebrated. This is highlighted in Table 4, which shows the region's achievements since 1990 in comparison to other parts of the world.

Table 4: Global poverty by region

Region	1990		2012	
	%	Millions	%	Millions
East Asia and Pacific	60.6	995.5	7.2	147.2
Europe and Central Asia	1.9	8.8	2.1	10.1
Latin America and Caribbean	17.8	78.2	5.6	33.7
Middle East and North Africa[91]	[5.8]	[13.1]	[2.3]	–
South Asia	50.6	574.6	18.8	309.2
Sub-Saharan Africa	56.8	287.6	42.7	388.8
World	37.1	1,958.6	12.7	896.7

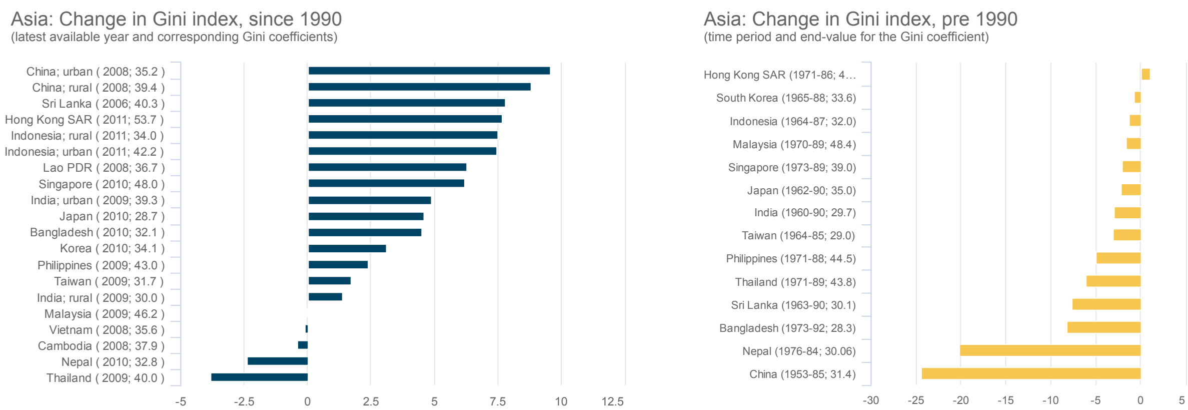
Sources: World Bank, *Global Monitoring Report 2015/2016: Development Goals in an Era of Demographic Change* (Washington DC: World Bank, 2016), 4, http://www.worldbank.org/en/publication/global-monitoring-report

But extreme poverty is still a grim reality for almost half of the region's population. The other reality is that the boundaries of poverty are changing. As one non-government organisation (NGO) stakeholder interviewed for this report noted, it is increasingly less relevant to look at poor countries; instead, the focus needs to be on poor people. This is highlighted by the fact that 73 per cent of the world's poor live in middle-income countries.[92] They can be found in the lagging regions of otherwise increasingly prosperous countries, or in excluded populations including ethnic minorities within middle-income countries.

A related and disturbing trend is increasing economic inequality, which is greater in Asia than in other emerging regions. The IMF has found that as the size and purchasing power of Asia's middle class has grown in the past two decades, their share of overall income has fallen while that of the richest quintile has increased. This is in contrast to Latin America, the Middle East, and North Africa, where the share of the richest quintile has fallen.[93]

In a description of what has been happening in China and India, the IMF notes that while both countries have seen considerable poverty reduction since their economic development, inequality has also increased, particularly in China. A widening of disparities between rural and urban areas, as well as between regions and states, was identified as a significant factor in the rise in inequality.[94] But it is not just China and India where there has been an increase in inequality. How this plays out across the region can be seen in Figure 6, which uses the Gini index to identify the extent to which the distribution of wealth is becoming more unequal.[95]

Figure 6: Growing inequality within Asia



Source: Ravi Balakrishnan, Chad Steinberg and Murtaza Syed, "The Elusive Quest for Inclusive Growth: Growth, Poverty and Inequality in Asia", IMF Working Paper No 13/152, June 2013, 5

The IMF has identified two factors contributing to this rise: skill-based technological change; and the transition from agriculture to industry for lower-income Asian economies.[96] It could also be argued that the failure of many governments in the region to adopt policies to address rising inequality is also a contributing factor. The UK's Overseas Development Institute has found that there are considerable disparities within countries between urban and rural areas; men and women; and ethnic, language, and caste groups. The inequality is not only evident in terms of income but also in other areas of development including education, housing, and access to services.[97]

Addressing inequality is important on a number of levels and the ADB has identified it as a constraint to poverty reduction. The difficulty is that the drivers of inequality are the same forces supporting stronger economies: technological progress, globalisation, and market-oriented reform.[98] While these factors open new opportunities, their benefits do not accrue to all people equally in part because they affect income differences through capital, skill, and location.

INFRASTRUCTURE GAP AND CONNECTIVITY

Asia's infrastructure gap, estimated to be worth $8 trillion, is not just a stellar statistic. It has often been cited as one of the reasons that led China to create the AIIB.[99] The gap itself first came to prominence in a joint study by the ADB and ADB Institute. The report, *Infrastructure for a Seamless Asia,* argued that the region needed improved connectivity to harvest welfare gains through increased market access, reduced trade costs, and more efficient energy production use.[100] It claimed that if the required investment was made in the region's transport, communications, and energy infrastructure over the decade from 2010 to 2020, developing Asia's real income could reach $13 trillion. However, to reach this, Asia needed to invest around $8 trillion in national infrastructure over the same time frame — 68 per cent for new capacity and 32 per cent for maintaining and replacing existing infrastructure. In addition, another $290 billion would need to be spent on specific regional infrastructure projects.

The report also argues that inadequate physical infrastructure is not only an impediment to growth, but is also one of the root causes of poverty. Addressing the deficiencies of Asia's national infrastructure is a priority because in part it creates the foundation for wider sub-regional and regional infrastructure networks. These findings were reinforced by a later study in 2012 which noted that, despite some progress, the quantity and quality of the region's infrastructure was generally lower than the global average and had not kept pace with the region's economic growth.[101] That study goes on to note that another infrastructure-specific challenge was weak or underdeveloped regional connectivity.[102]

Addressing the region's infrastructure and connectivity means addressing the risks and uncertainties linked to regional investments and the lack of public funding. There are several other factors which also need to be addressed including: governance and legal frameworks to ensure a transparent operating environment that has the laws and administrative capacity to support scaled-up investment in infrastructure; a deeper understanding of the importance of the risk environment for private sector investors; the impact of infrastructure development on communities and the environment; and the inclusion of information and communication technology to support among other things efficient and timely financial exchanges and transactions across borders.

Undoubtedly, however, the most important question that needs to be addressed is financing. It is widely recognised that there are sufficient and motivated sources of financing across the region that could be drawn from domestic savings and available foreign capital. But the ADB's 2009 report noted that the financing reality is complicated because national governments are reluctant to finance infrastructure investment through foreign borrowing, while most of Asia's domestic savings are not at the disposal of national governments.[103]

The ADB is no longer able to meet even a sizeable proportion of these funding needs for infrastructure. The challenge therefore is determining how the ADB can facilitate greater private sector investment by supporting national policy and safeguards reform, as well as strengthening intra-region connectivity. This will be discussed in more detail in Chapter 3.

BOX B: SECURING ENERGY — INFRASTRUCTURE AND THE ENVIRONMENT HAND IN GLOVE

According to the International Energy Agency (IEA), the global share of electricity generation in developing Asia has increased from 5.5 per cent in 1973 to 35 per cent in 2015. China and India were the world's top and third-largest producers, net exporters, and net importers of electricity in 2014, respectively.[104] But these statistics hide the prevailing reality of energy poverty in a number of areas across Asia and notably in South Asia, including India. In its in-depth country focus on India, the IEA's 2015 *World Energy Outlook* notes that although India contributes the single largest share of global energy demand, 240 million Indians (one in five of the population) still lack access to electricity.[105]

More broadly, the most recent statistics from the United Nations Executive Secretary Member States Secretariat Programme (UNESCAP) provide a spotlight on the regional and country differences.[106] As can be seen in Table 5, at a macro level, both East and North-East Asia as well as North and Central Asia have around 100 per cent of their populations enjoying access to electricity in 2012, while South and South-West Asia access is only 80 per cent, with a number of South Asian countries significantly less than the sub-regional average.

But the development need for energy highlights the inherent challenges in responding to the demands while addressing critical environmental and climate-change related issues. Energy security is a core requirement for economic development but to be sustainable in the long term, it needs to also address environmental consequences. Sustainable energy will be critical for an effective response to climate change.

For the challenges facing Asia that are core to the ADB's role, this touches both on policies and approaches to addressing the infrastructure gap as well as outstanding environment issues and climate change.

Table 5: Access to electricity (% of population)

	1990	2012
East and North-East Asia	**94**	**99**
China	94	100
Mongolia	80	90
Cambodia	19	31
Indonesia	67	96
Lao PDR	52	70
Myanmar	43	52
Philippines	65	88
Timor-Leste	32	42
Vietnam	88	99

South and South-West Asia	**54**	**80**
Afghanistan	35	43
Bangladesh	22	60
Bhutan	66	76
India	51	79
Nepal	70	76
Pakistan	60	94
Sri Lanka	78	89
North and Central Asia	**99**	**100**

Source: UNESCAP Online Statistical Database

CLIMATE CHANGE AND THE ENVIRONMENT

According to the 2014 assessment by the Intergovernmental Panel on Climate, the impact of climate change across the Asian region has resulted in warming trends, increasing temperature extremes, as well as strong variability in precipitation.[107] The environmental and social stresses from urbanisation and industrialisation are also adversely affecting natural resources and the environment. Food security and affected production areas are experiencing a decline in productivity, particularly in rice production where a number of regions are already near the heat stress limits for this crop.

Populations in low-lying coastal zones and flood plains are considered most at risk from the effects of climate change. Half of Asia's urban population lives in these areas. Furthermore, Asia is home to more than 90 per cent of the global population exposed to tropical cyclones, the impact of which is exacerbated for low-lying and coastal communities by rising sea levels.[108] The ADB's own report on climate change in Southeast Asia warns that the worst effects of climate change are still to come, and threaten the region's development and poverty eradication efforts.[109] The World Bank warns that climate change is not just an environmental issue but also one with severe socioeconomic implications in South Asia, particularly for the poorest peoples.[110]

TECTONIC DEMOGRAPHIC SHIFTS: AGE AND PLACE

Asia is facing two major demographic shifts: ageing populations and urbanisation. Neither trend is necessarily negative: the former points to a demographic success story thanks to improvements in fertility and mortality resulting from economic and social development; while the latter offers significant opportunity for economic development and prosperity. However, these trends demand policy settings and responses that reflect the changing demands and pressures that are inherent in both.

Ageing populations

Demographically, Asia, like much of the rest of the world, is at a turning point as the population grows more slowly, while ageing at an unprecedented rate.[111] The proportion of the world's working-age population (aged 15 to 64 years) reached its peak in 2012 and is now starting to fall. The number of children aged less than 15 years has plateaued to around 2 billion. According to the United Nations, there were 901 million people aged 60 years or over in 2015, an increase of 48 per cent since 2000.[112] Significantly, two-thirds of the world's oldest people live in developing regions. Asia is currently the second-fastest ageing region with a projected 66 per cent increase in its population aged 60 years or over by 2030 compared with North America at 41 per cent and Europe at 23 per cent. Globally, this represents 60 per cent of the world's population over 60. It will also be home to 58 per cent of the world's population aged 80 years or over. According to the United Nations, the older segment of the population is growing faster in urban areas than in rural areas.

The region's demographic transition will have a substantial effect on its economic growth in the next two decades, changing the demographic dividend which drove economic growth in the past into a demographic tax.[113] As one study recently noted, the magnitude and timing of this transition will vary from economy to economy but will affect economic growth across the region.[114]

Urbanisation

Urbanisation is a common phenomenon across Asia although East Asia stands out as the region where rapid urban expansion and population growth is particularly marked. According to the World Bank, the urban population of the region increased from 579 million in 2000 to 778 million in 2010, an average annual growth rate of 3 per cent with China leading this urban population growth at twice the pace of the rest of the region combined.[115] The fastest annual rates of urban expansion were in Laos (7.3 per cent) and Cambodia (4.3 per cent) followed by China (3.1 per cent) and Vietnam (2.8 per cent). Surprisingly, however, despite the large urban population of East Asia, it represented only 36 per cent of the total population in 2010.[116]

Similarly, South Asia's urban population represented just under 31 per cent of the total population although its urban population will grow by almost 250 million people by 2030.[117] While this increase across South Asia could continue to support economic growth, the majority of South Asia's cities remain characterised by high levels of poverty with urban dwellers below the national poverty line ranging from one in eight in Pakistan to more than one in four in Afghanistan.[118]

Asia's ageing population and urbanisation will have major implications for a range of financial and service delivery policy settings. However, the picture is a mixed one and serves to underscore the interconnectedness between issues challenging the region. For example, in terms of ageing populations, the IMF argues that demographic change affects economies in several ways, both positively and negatively. In particular, the savings issue has the potential to affect the infrastructure gap:

> "Several emerging Asia economies with favourable demographic transitions will face the challenge of mobilizing resources to finance infrastructure investment. Despite their favourable demographic transition that would raise growth potential … countries such as India, Indonesia and the Philippines continue to suffer from underdeveloped infrastructure."[119]

And as urban centres continue to grow, the demand for infrastructure to support expanding populations and improve the liveability of the cities will increase exponentially.

MIDDLE-INCOME TRAP OR AN INEVITABLE SLOWING DOWN?

There is little doubt that Asia, as a region, has made significant progress economically in a relatively brief period. However, while many of the ADB's developing member countries have moved into the middle-income category, only 8 out of the 26 are in the upper middle-income category.

Making the leap from middle income to high income is fraught with difficulties. The middle-income trap is the result of a situation where countries can neither compete against more advanced economies, or compete with poorer economies because their labour is no longer cheap. There are a variety of views as to why countries fall into the middle-income trap. Homi Kharas, one of the original authors of the concept, has argued that most Asian countries are unlikely to face immediate economic danger. Kharas notes that middle-income traps build slowly over time, strangling economies by absorbing resources that could be put to more effective use and constraining policy space. He does not offer a set policy prescription for avoiding the trap but sees it as caused primarily by governance failure.[120]

However, others caution against putting too much emphasis on the middle-income trap concept. As one stakeholder from a major development institute interviewed for this report noted, "if you are a successful country, you will slow down so you can't tell if you are on the pathway to higher income or simply stuck". In other words, economic progress is not a straightforward one-way trajectory and its pace is not set to one speed. Understanding why there has been a slowing down in the pace of countries moving into the upper middle-income bracket needs to be looked at country by country; it is not a simple 'trap' phenomenon that fits all.

RESPONDING TO THE CHALLENGES

WHAT THE ADB IS DOING

The recommendations that came out of the 2014 mid-term review of the ADB's 2020 Strategy identified a list of strategic priorities: poverty reduction and inclusive economic growth; environment and climate change; regional cooperation and integration; and infrastructure development.[121] It also listed priority actions that should be taken in responding to the "new business environment" with an emphasis on middle-income countries; private sector development; and knowledge solutions.[122]

The ADB's response to the region's changing landscape and dominant challenges has not just been influenced by regional circumstances, or even its own mid-term review; it has also been shaped by the broader international development policy landscape. In this regard, 2015 was a seminal year. In July 2015, the third International Conference on Financing for Development in Addis Ababa saw a renewed global commitment to financial support and technical assistance for the new global development agenda, encompassed in the 17 Sustainable Development Goals (SDGs), which were adopted by the international community in September 2015. In December 2015, the 21st Conference of Parties on Climate Change in Paris sealed a new climate change deal.

This new international development agenda with its core focus on sustainable development emphasises inclusion, ending poverty, and addressing climate change. As such, it reflects the ADB's existing strategic focus in a broad sense, which in turn is reflected in the ADB's investment priorities. According to its 2015 annual report, the ADB "continued to strive for inclusive economic growth" investing in "a range of programs and projects to create and expand economic opportunities — especially for the poor and disadvantaged — and support social protection to reduce poverty and vulnerability".[123] Regional cooperation and integration saw an investment of $3.8 billion plus an additional $94 million for technical assistance; while 65 loans and grant projects worth more than $7 billion were approved to support environmental sustainability. While there was no specific reference to infrastructure as a priority sector, the report highlights spending on transport ($2.8 billion), urban development ($2 billion), and water ($2.2 billion). Climate financing totalled $2.92 billion. The Bank also announced its intention to double climate financing to $6 billion a year by 2020.[124]

WHAT ADB MEMBER COUNTRIES WANT

Possibly one of the biggest challenges for the Bank is managing the diverse ambitions of its shareholders, that is its member countries. Stakeholders interviewed for this report provide some insights.[125] A senior official involved in the latest replenishment round noted that in determining the priorities for the Bank, it is essential to remember that it is the shareholders who lead the Bank. Stakeholders caution that the priorities and expectations set by the owners of the Bank can "lead to frustrations and inconsistencies, imposing demands on the management without considering the impact".

A former donor country ADB Director noted the Bank understands the changes happening in global development, but has limited capacity to influence change as a relatively small institution. Another stakeholder, from a development think tank, warned that it was always hard for any institution to give up on things that the broader donor community was talking about. The breadth of issues covered by the SDGs is a clear example. As one stakeholder who has been both a Bank official and donor representative also warned, the ADB risks being caught in the swirl of the SDGs and will struggle with the big agenda. The ADB needs to be guided by its members, even if some countries are entrenched in the day-to-day and cannot look ahead.

The breadth of shareholder expectations was reflected in the Governors' statements presented at the 2016 ADB annual meeting held in Frankfurt. Japan placed an emphasis on infrastructure, calling for the ADB to effectively use its limited resources and take full advantage of the

ADF–OCR merger to respond to the massive need for infrastructure. Korea urged the ADB to step up its efforts to better serve the needs of recipient countries, in particular addressing fragile and conflict-affected situations, and strengthen private sector development. Australia's emphasis was on the Bank's efforts to foster private sector investment in infrastructure development — in part reflecting Australia's own national policy emphasis. Similar to Korea, Australia encouraged the Bank to step up its efforts for fragile, conflict-affected, and small island states as well as promoting economic opportunities for women and girls, but was silent on the ADB's role in climate change response.

The United States positioned the ADB within the new international development environment. It saw the need for the ADB's proposed Strategy 2030 to evolve in line with changes in the development landscape, setting out clear themes based on the ADB's comparative advantages and targeting the poorest. But at the same time, the United States urged the ADB not to veer from its core function as an infrastructure-focused project finance bank, while maintaining its commitment to strong social, environmental, and procurement standards. It also applauded the ADB's decision to double its annual climate financing. Canada also welcomed the Bank's commitment to the SDGs and the climate agreement, and was clear that poverty reduction and inclusive growth and assistance to the poorest and most vulnerable developing member countries (such as fragile and conflict-affected countries) should remain the Bank's central mandate.

The United Kingdom also called on the Bank to respond to the changing realities and demands with a strategy for engagement in Asia's upper middle-income countries. It urged the ADB to be stronger on inclusive growth with a focus on infrastructure and support to make businesses more inclusive. In particular, the United Kingdom wants the private sector to create jobs and livelihoods for poor and marginalised women and men. At the same time, it asked the Bank to do more to ensure no one was left behind. It supported the Bank's efforts to make sure all projects were "climate smart".

In contrast, China called for a more "forward-looking" development strategy that no longer had poverty eradication as its only objective. With the increasing number of developing members now middle-income and upper middle-income countries, the priority for them was no longer just poverty relief, but the achievement of sustainable development around three pillars: social, economic, and environmental. There was also an expectation that the ADB would support developing members to address climate change and other global challenges, participate in the provision of regional and global public goods, and promote South-South cooperation.

Indonesia's emphasis was on urging the ADB to direct enhanced resources to eradicate poverty and strengthen sustainable development, including to finance infrastructure development. India did not highlight any particular broad regional development challenge but instead suggested that the proposed 2030 Strategy should focus on becoming an agent for change by supporting innovative and catalytic projects and activities that would otherwise not happen through local intervention. Cambodia identified a paradigm shift in the global development agenda with the adoption of the SDGs and the climate agreement. It saw this shift as requiring the ADB to take a central role in this new framework and help shape the new direction of the region, while not neglecting the capacity and needs of member countries, especially the poor ones. Vietnam strongly supported the ADB implementing the priorities identified in its 2020 Strategy and appreciated the ADB's efforts to develop the 2030 Strategy focusing on three pillars: more innovative and productive economies, enhanced and more inclusive service delivery, and improved environmental sustainability and climate change adaptation.

Among the ADB's poorest members, Afghanistan emphasised its need for ADB support given its current fragile and conflict-affected situation. It saw the ADB not only connecting the region through investments in infrastructure but also by bringing people from Asia and beyond closer in the spirit of connectivity. Myanmar also picked up a similar approach appreciating the ADB's coordination in supporting sustainable and inclusive growth with the theme of connectivity. Uzbekistan emphasised the collaborative partnership with the ADB and its focus was on possible improvements to the ADB's operational efficiency.

This range of member country views demonstrates the breadth of the ambitious agenda that the ADB is expected to respond to. It also points to some fundamental differences between developed and developing member country expectations and perspectives, if indeed the categories of 'developed' and 'developing' remain appropriate. Added to the mix is the dramatic expansion of the international development agenda encapsulated by the 17 SDGs. The ongoing task for the Bank and its board is and always has been to get shareholder agreement on the priorities for Asia's bank to ensure it remains relevant to the region.

BOX C: ADDRESSING GENDER INEQUALITY STARTS AT HOME

For much of 2015, there were no women in the vice-president ranks of the ADB. Less than 12 months later there were two. Was this a sheer coincidence or had the Bank finally recognised that addressing gender inequality in Asia starts at home or, in this case, headquarters?

A glance through the Bank's decade of annual reports since 2006 shows it is neither. The ratio of female to male vice presidents has usually been one to six and very occasionally two to six. This is a pervasive trend throughout the organisation, where professional female staff have remained stuck at around 30 per cent of all ADB professionals for the past decade. There has never been a female president. Even at the third level of management within the Bank, only 17 per cent or 5 of the 28 directors general (or equivalent) positions were held by women, according to the Bank's February 2016 organisational chart.[126] This record is clearly at odds with the institution's own policy on gender equity, which is one of the five drivers of change to achieve the Bank's 2020 Strategy.

The Bank's gender strategy recognises that while great strides in narrowing gender indicators have been achieved, progress has not been spread widely or evenly across the region. It acknowledges that while the ADB's approach to gender mainstreaming had delivered good results, this approach may not be sufficient to narrow gaps and inequalities on its own.

Of course, no one strategy by any single institution is going to close the gender equality gap which persists across Asia where there are cultural and economic gender biases in favour of men. The challenge is highlighted by the fact that tens of millions of women are 'missing' across the region. These are the women who were never born because they were aborted before birth or murdered shortly after birth simply because they were female. Economist Amartya Sen estimated in the early 1990s that there were more than 100 million women missing across Asia.[127] In the mid-2000s, it was estimated that in India alone, 50 million women were missing.[128] A report by Action Aid in 2009 showed that the practice was continuing, at least in northern India.[129]

Aside from this culturally condoned human rights travesty, poverty is more often than not a burden carried by women. And while the global rate of extreme poverty is falling, it is increasing among women and girls in the rural areas of developing Asia as men go to the cities to find work leaving the women behind to take care of the farm and family.[130]

Evidence abounds about the importance of valuing women and girls as much as men and boys, not just because it is the right thing to do, but because of the flow-on positive effects this has for the prosperity and stability of communities and society as a whole. So it is no surprise that the ADB's role in addressing gender inequity and inequality through its work remains an important priority, at least for some Bank members despite what some described in discussions with the report's authors as the ADB's systemic bias.

While ADB gender balance statistics might confirm that bias, it is the Bank's own members that are failing even more conclusively in dealing with their own biases. For the past ten years, at any one time, there has rarely been more than three women on the board. For the ADB to be true to its own stated mission of reducing poverty across the region, one of the first priorities along this pathway has to be addressing the poverty of women and girls. This requires not just a program strategy and action plan, but a whole-of-Bank effort to address its own biases, in management and members alike.

WHAT STAKEHOLDERS THINK

Just as the ADB shareholder's views ranged ambitiously over a wide territory of development priorities, so too did the views of the non-member stakeholders: academics, civil society representatives, private sector representatives, and ADB staff.

On the issue of poverty, several ADB staff were influenced by the Bank's optimistic outlook that most of Asia was expected to be middle income by 2020. One senior official also referred to the fact that the ADB charter made no mention of poverty, while members of a combined constituency acknowledged that there had been some debate about whether poverty should still be the cornerstone of the ADB's mission. NGO stakeholders, on the other hand, were critical of the Bank's approach to addressing poverty and worried that the "ADB isn't listening to the voices of the poor". In part this is linked to a criticism shared by non-government stakeholders about the ADB's limited involvement with communities at the grassroots level. As one senior civil society representative noted:

> "ADB hasn't reached out to work with CSOs. They don't communicate; they don't exchange information. ADB is operating at the macro level and CSOs are at the grassroots where the poor are living so they should be talking to us to get the full picture."

Overall, the majority view was that the focus should still be on poverty reduction. As one senior ADB official stated:

> "Clearly, the region has been successful in addressing poverty and growth. But absolute numbers of poor are still larger than Africa. And the middle-income trap is very real and hard to solve. Clearly there is a role for ADB."

Regarding the Bank's strong focus on infrastructure, a minority view held by some senior ADB officials was that the Bank should be reorienting towards social sectors, particularly health and education. A developed country member aid agency agreed that the ADB needed to be stronger in education and health and argued that "infrastructure cannot be done alone; there needs to be a more holistic approach and a stronger policy dialogue in social sectors". Another developed country member representative wanted the ADB to take a stronger role in health, with a particular emphasis on regional health security. There was also a view that in addressing the underlying causes of the growing trend in inequality, it was essential for the ADB to take a greater role in supporting health and education in the region. An opposing view came from a developing country think tank: "it is doubtful that focusing on health and education is enough to get to development because there is no causal link with growth."

Infrastructure was generally viewed as a top issue for the ADB. "Inclusive infrastructure is what [the ADB] do the best and MDBs, including the ADB, can't do all the SDGs," was one view which was echoed by a number of stakeholders. But while there was some anecdotal discussion about the ADB meeting just 2 per cent of the infrastructure gap, a private sector stakeholder saw the real problem being the lack of bankable projects:

> "There is plenty of money and a lot of institutions are desperate to find investments — bankable projects — but the problem is the lack of capacity of governments to fulfill the design safeguards and good governance frameworks to support the private sector investments. The governments don't know how to allocate risks between the public and private sector. So it is the role of the ADB, as a knowledge bank, to help them in this area."

Other stakeholders also saw the ADB's protection and promotion of safeguards as a major strength:

> "It is important that the money is spent properly. Environment, human settlement, and the rules of governance are essential. ADB should continue to take a critical role in maintaining global standards of doing business."

In the area of connectivity, the view of stakeholders was that the ADB has proven itself an "honest broker" capable of bringing together countries to undertake intra-regional projects, which in other circumstances would have been difficult to achieve because of long-standing animosity and distrust on the part of respective neighbouring countries. "ADB has a prominent role in the outcome of regional cooperation", according to a former senior ADB official and now head of a major NGO in the region. "Regional cooperation is often so hard without the intervention of a third party. This is where ADB has a strong role to play because it is trusted and neutral and has established good relations bilaterally." Another view, this one from a development think tank, was that the Bank needed to deepen and strengthen regional cooperation and support for regional public goods: "connectivity, transport corridors — getting these projects together is a screaming nightmare."

Climate change and the environment more generally were identified across the board as a major priority for the ADB. This theme also links to the ADB's role in providing public goods and its convening, facilitating, and regional responsibilities. A number of stakeholders considered the Bank's role in addressing climate change particularly important in light of the reluctance of sovereign governments to expend their own domestic political capital on an issue where there was no immediate visible return, or where the positive impact may be diffused across borders. The ADB is seen as being in a prominent position to focus on climate change and bring the private sector along. Some argued, however, that the ADB should be considering carefully what comparative advantage it brings to this issue, given the number of global climate change funding mechanisms that already exist. There are ways in which the ADB could consider innovative means of cooperation, for example acting as a 'retailer' for funds provided by global climate change funds or 'wholesalers' such as the Green Climate Fund. The ADB's work in disaster risk reduction was also seen as contributing to a significant regional good, although this had more significance for Pacific developing countries than Asian members.

Overall, the majority of stakeholders held the view that the three big priorities for the Bank remained the eradication of poverty and responding to the rising economic inequalities within countries; environment and climate change; and infrastructure and connectivity. There was a strong understanding of the inherent linkages between them. As one NGO stakeholder noted: climate change and environmental pollution combined with bad infrastructure will only contribute to poverty.

A big question that remains for the Bank is how far it should move further into the social sectors of health and education. There is no doubt that the social and economic development of a nation is dependent on the health and education of its people. But for a bank operating with limited resources, venturing more deeply into these sectors would mean there would be fewer available resources for their core business.

The Bank is respected across the region for maintaining and upholding development safeguards and protocols to ensure sustainable and appropriate investments. The ADB remains an important banker of public goods.[131] Without the Bank, there is a real risk that important public projects, whether national or sub-regional, would not otherwise be initiated due to their lack of profitability or even visibility. This is despite their core contribution to good development outcomes. However, the ADB can improve its own performance and adopt more innovative, faster, and flexible mechanisms. In other words, the broad consensus was that the Bank was already focused on the right ‘what’ but the big challenge is to improve the ‘how’. This will be dealt with in the next chapter.

CONCLUSION

Asia’s changing economic geography presents continuing and emerging challenges for the ADB. Despite the decline in absolute poverty, Asia still hosts half of the world’s poor and many of the ADB’s clients are in the lower middle-income strata with their peoples earning far less than in OECD countries. The ADB has prioritised inclusive and environmentally sustainable growth, and regional integration. There is inequality not just in incomes but also education, housing, and access to services. There are pockets of extreme poor within countries — in lagging regions or excluded populations. Asia’s infrastructure gaps also exacerbate poverty. Climate change is already affecting Asia and the environmental damage from rapid urbanisation and industrialisation is clear. Asia will have to monitor its food security and prepare for natural disasters. These issues intersect with the slowing economic pace of some countries and important demographic shifts across the region. In the 21st century, the ADB’s mandate requires it to continue to focus on poor people, even if there are fewer poor countries. In addressing the breadth of obstacles to alleviating poverty, the Bank, as the region’s development bank, should be focusing on the value-add it can and does bring to development at the country, sectoral, and thematic levels.

CHAPTER 3

THE CHANGING NATURE OF DEVELOPMENT FINANCE IN ASIA

Fifty years ago Asia was one of the poorest regions in the world, with most nations facing limited options for obtaining development finance both domestically and internationally. ODA and lending from MDBs was the primary source of external support and the development landscape was relatively homogenous. Since then, the amount of foreign aid available has increased dramatically. Globally, it has grown in real terms from $47 billion in 1968 to $146 billion in 2015. Foreign aid to ADB member nations, however, has remained remarkably constant over the past 50 years or so, starting at $18 billion in 1968 and ending at $17 billion in 2014, and never reaching above $20 billion.

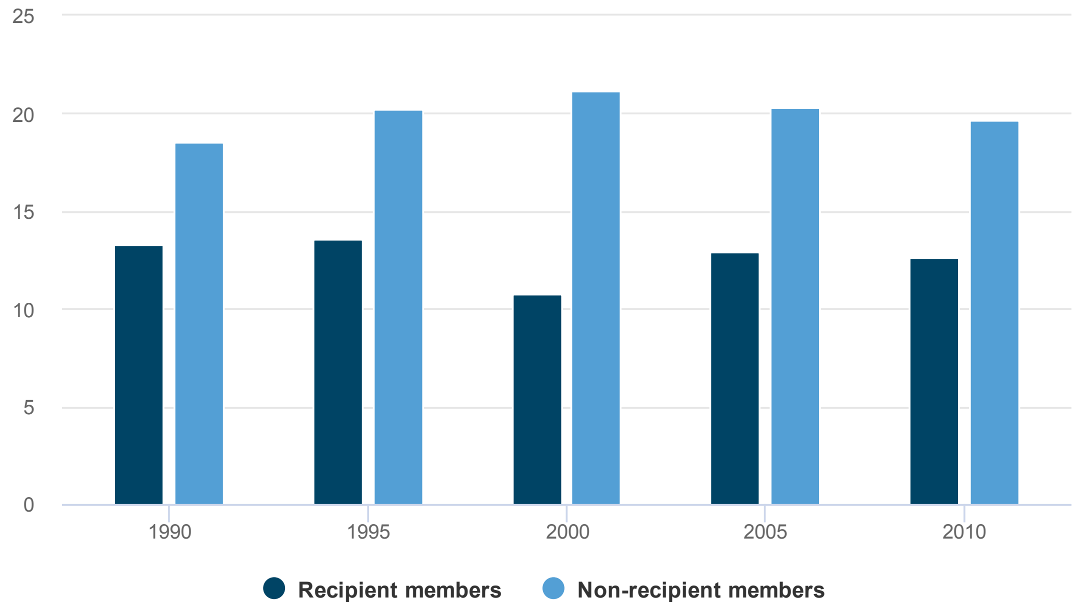
In that time the development sector has matured, but has also become more complex, with new actors and lending modalities. In 1966, there were 14 bilateral and three multilateral agencies engaged in development assistance activities in the world, including ADB member countries. Today there are 29 bilateral and 38 multilateral agencies engaged in ADB member countries, with hundreds more vertical and multilateral funds operating around the world, and countless NGOs, non-traditional donors, and philanthropic organisations engaged throughout the region.[132]

This chapter will discuss how rapidly development finance in Asia has evolved over the past 50 years, and the role infrastructure has had, and will continue to play, in the region. It will highlight that while Asia has developed at a startling rate, the demand for quality infrastructure in the region is still significant. Building on the context established in Chapters 1 and 2, this chapter will then explore ways in which the ADB is adapting to a new role in the 21st century, exploring elements such as the merging and expanding of lending activities, who the ADB lends to, graduation, changing lending modalities, and the role of knowledge within the Bank. Exploring the way in which the Bank operates will help set the scene for this report's recommendations, discussed in the final section.

AID FLOWS IN ASIA

Foreign aid flows in Asia have been dramatically overshadowed by the growth of other domestic and external sources of finance. As countries throughout Asia have developed, their ability to mobilise domestic resources has improved, enabling more domestic-led investment. Government spending across the Asia-Pacific region has grown from an average of 17 per cent of GDP in 1995 to 26 per cent (over $45 trillion) in 2012.[133] There is, however, still a significant gap between donor and recipient ADB member countries' ability to harness domestic tax revenue to fund their own investment needs, including infrastructure projects, as illustrated in Figure 7.

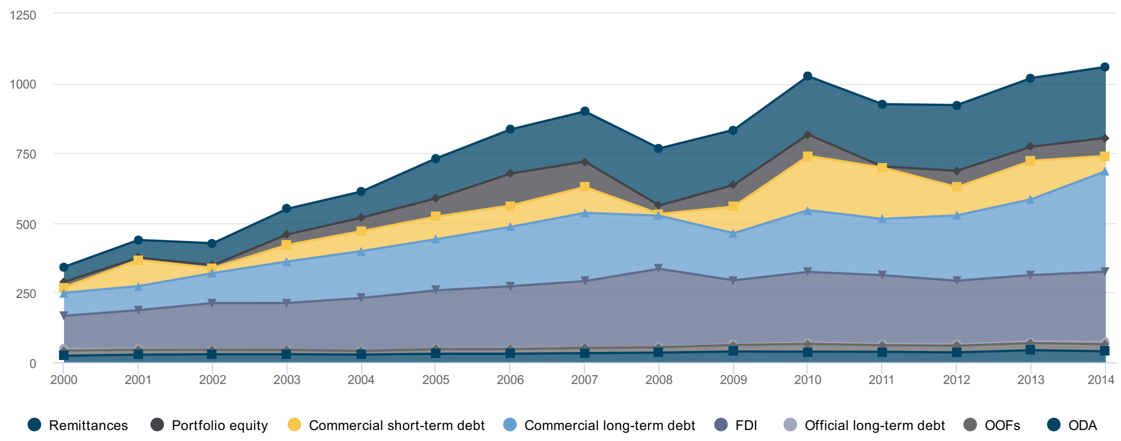
Figure 7: Tax revenue as % of GDP of recipient vs non-recipient member countries (unweighted average)



Sources: World Bank, "Tax Revenue (% of GDP): 1972–2002", http://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS; authors' calculations

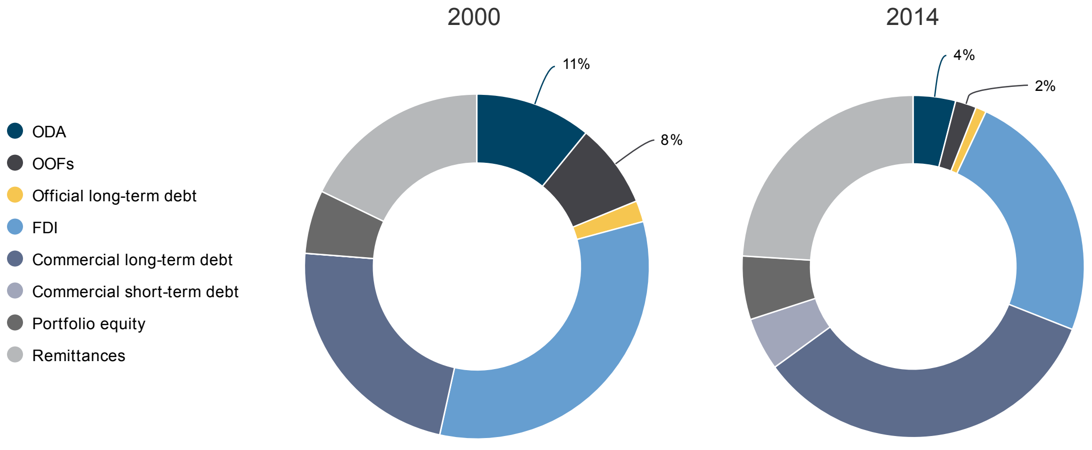
Since 2000, international capital flows to Asia have increased dramatically thanks to better macroeconomic conditions (greater fiscal buffers, sustained economic growth, low inflation rates), improved domestic policy frameworks and implementation, and greater appetite for risk from international investors.[134] Throughout Asia, member countries are now able to take advantage of not only ODA and other official flows (OOF) but also foreign direct investment (FDI), portfolio equity inflows, bonds, short-term debt, long-term debt, remittances, and other sources of private finance. These rapidly growing sources of finance now dwarf foreign aid. However, considering that 3.8 billion people reside in ADB recipient countries, this huge sum of international finance still amounts to only $278 per capita.

Figure 8: Growth of various international financing streams to member countries, 2000–2014 (2010 US$ billion)



Source: Development Initiatives, "The Development Data Hub", http://data.devinit.org/#!/

Figure 9: Share of international financing streams to all member countries, 2000 vs 2014



Source: Development Initiatives, "The Development Data Hub", http://data.devinit.org/#!/

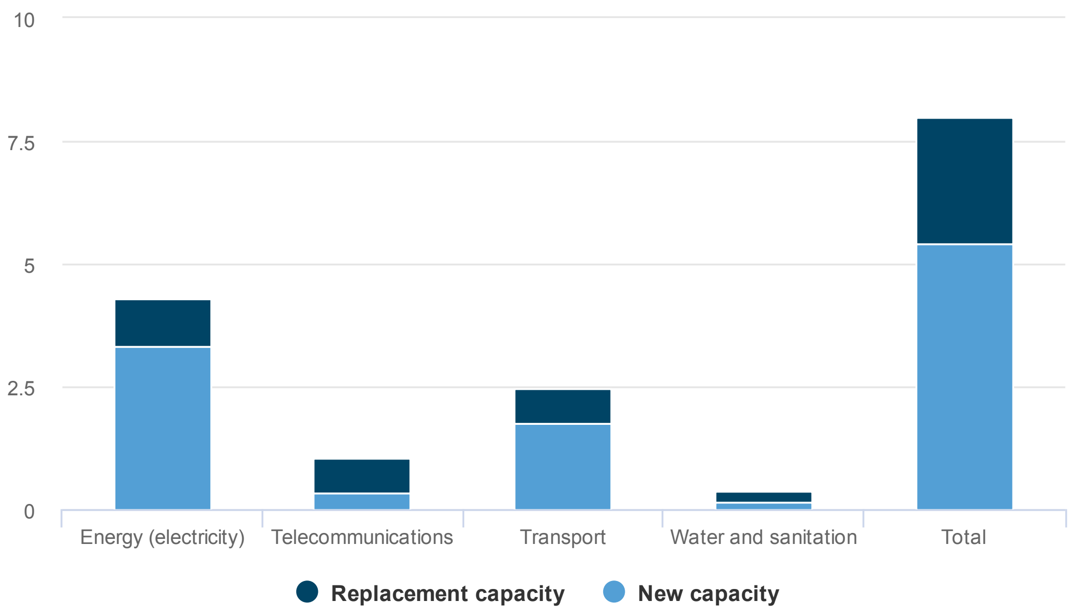
The decline in the relevance of conventional development finance has had significant ramifications for the ADB. In 1980, ADB lending to member countries made up 10 per cent of total inflows of foreign aid, remittances, and FDI. In 2014, that number is down to 1 per cent. Over that time, foreign aid as a whole has fallen from a 30 per cent share of the inflows of foreign aid, remittances, and FDI to just 1.6 per cent.[135] This is undoubtedly a good thing for

Asia. The economic growth that has opened up these financial resources has pulled hundreds of millions of people out of poverty.

The Bank's declining financial relevance also poses legitimate questions about its role and relevance as an institution in the 21st century. With the ADB now contributing such a finite amount of development finance to its member countries, donors may start to wonder why the ADB is needed at all. It is important also to recognise, however, that the supply of development finance is only one half of the equation. As Asia continues to rapidly develop and urbanise, the demand for quality public infrastructure is vastly outstripping supply.

Because of the public goods nature of most infrastructure investment, many sources of external finance, such as FDI, remittances, and portfolio equity will not fill the gap. Rising public debt in many countries in Asia such as India, Indonesia, and the Philippines will constrain public infrastructure investment, compounded by limited private sector participation and a lack of long-term capital market financing.[136] In Indonesia, for example, infrastructure investment has declined from about 6 per cent of GDP in the 1990s to only 3 per cent of GDP during the past ten years, leaving a huge infrastructure funding gap that needs to be filled.[137] The most comprehensive estimate of this gap across Asia, forecast by the ADB itself, puts the gap at $8 trillion between 2010 and 2020, or roughly 4 per cent of the region's GDP over that period.[138] Filling this void will require every available avenue of financing Asia can find.

Figure 10: Estimated infrastructure needs in ADB member countries 2010–2012 (US$ trillion)



Source: ADB and ADBI, *Infrastructure for a Seamless Asia* (Tokyo: ADBI, 2009), 167

Multilateral development finance in this context is critical not just because of the funding it can provide, but also because of the unique mandate the ADB enjoys. While loans from the ADB represent a declining proportion of overall resources to the region, they are unique in their ability to target poverty reduction and investment in public goods that are not feasible for most types of external finance. In interviews with the authors, a number of stakeholders from member countries, the private sector, and academia argued that the Bank, with its experience, expertise, and reputation, has a critical role to play in meeting the infrastructure needs of the region by: helping to establish a pipeline of bankable projects in the region; assisting governments to reform regulatory environments to unlock broader investment; providing critical technical expertise to member countries; working across borders and in critical cross-regional infrastructure initiatives; and acting as an honest broker in international forums throughout the region. These contributions are perceived by many of those interviewed to have more impact in the region than the direct spending of the ADB itself.

With diverse financing options in the region, the Bank is under pressure to evolve and adapt to this new context. It will have to be more nimble and more reactive to recipient needs in order to remain an attractive partner in the region. But this should not come at the expense of appropriate safeguards, skills, and quality that make its lending so valuable to the region. Fortunately, the Bank is aware of this challenge and it is adapting.

ADAPTING TO A NEW ROLE IN THE 21ST CENTURY

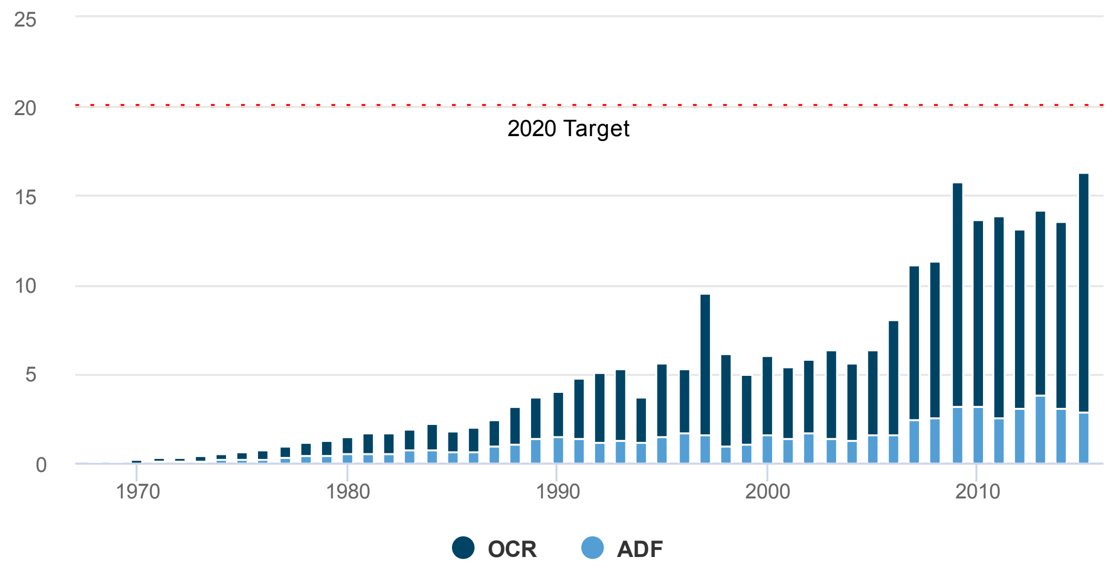
The ADB is constantly evolving to respond to the changing Asian environment. The speed of this change has only increased this century. While there are many minor reforms the Bank is enacting, this section highlights areas in which the changes within the Bank have been most pronounced and the challenges most acute.

MERGING AND EXPANDING LENDING ACTIVITIES

Despite the ADB’s declining relevance in the field of development finance in Asia, it is still a critical player in the provision of public infrastructure in the region. Responding to the massive infrastructure deficit in the region, as well as criticism of its Strategy 2020 that proposed the ADB move away from infrastructure financing, the ADB is going through an unprecedented expansion of its lending operations.

Since 1980, approved lending from the ADB has quadrupled, when adjusted for inflation. Between 2003 and 2012 alone, the ADB has doubled its yearly approved lending. As at 2015, the ADB had committed $16 billion in direct lending across 250 projects, with an average project size of $65 million. In addition to this direct funding, the ADB secured $10.74 billion from other donors through co-financing.[139] This expansion is not over, with the Bank expecting to continue to increase its lending to $20 billion by 2020, with the bold ambition of reaching a 1:1 co-financing ratio with other donors, leveraging this amount up to $40 billion in approved development finance a year. For an institution that at the turn of the 21st century was lending, in real terms, $7.5 billion before co-financing and $11.3 billion with co-financing, this is a profound and dramatic scale-up.[140]

Figure 11: OCR and ADF lending, 1968–2015 (2010 US$ billion)



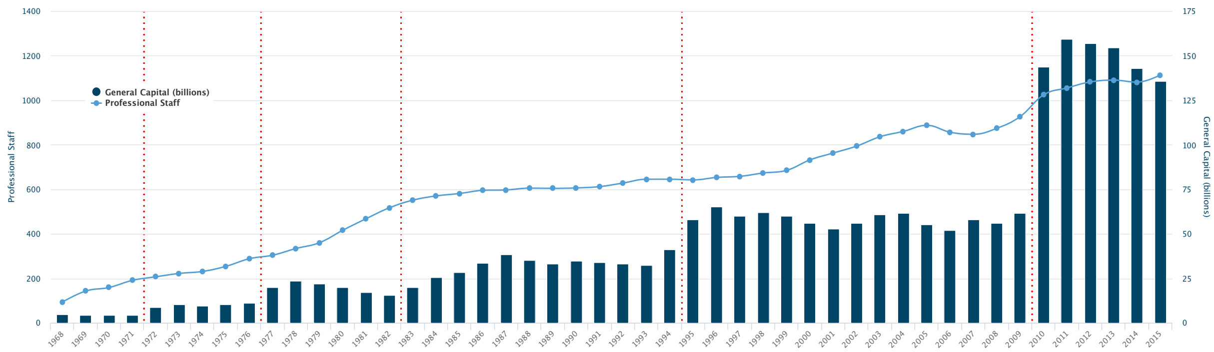
Note: 1997 is an aberration because of an extraordinary $4 billion loan to South Korea during the Asian financial crisis, which was quickly paid back as the crisis abated

Sources: ADB lending database; authors' calculations

The ADB has been able to implement this rapid expansion by undertaking a dramatic reform of the way in which it structures its lending operations. In 2015, the ADB board approved the merging of the ADB's concessional and non-concessional lending arms — the ADF and the OCR — which will take effect in January 2017. Since the ADF is a completely paid-in fund, this new capital injection will enable the ADB to almost triple its equity from $18 billion to around $53 billion. Because ADF resources will now be leveraged through financial markets, the Bank expects that the move will allow it to increase concessional assistance to poor countries by up to 70 per cent while reducing paid-in donor contributions by up to 50 per cent. This is a bold move, and the first of its kind for any MDB. While largely heralded as visionary, the merger also brings with it significant downside risk that will need to be appropriately managed.

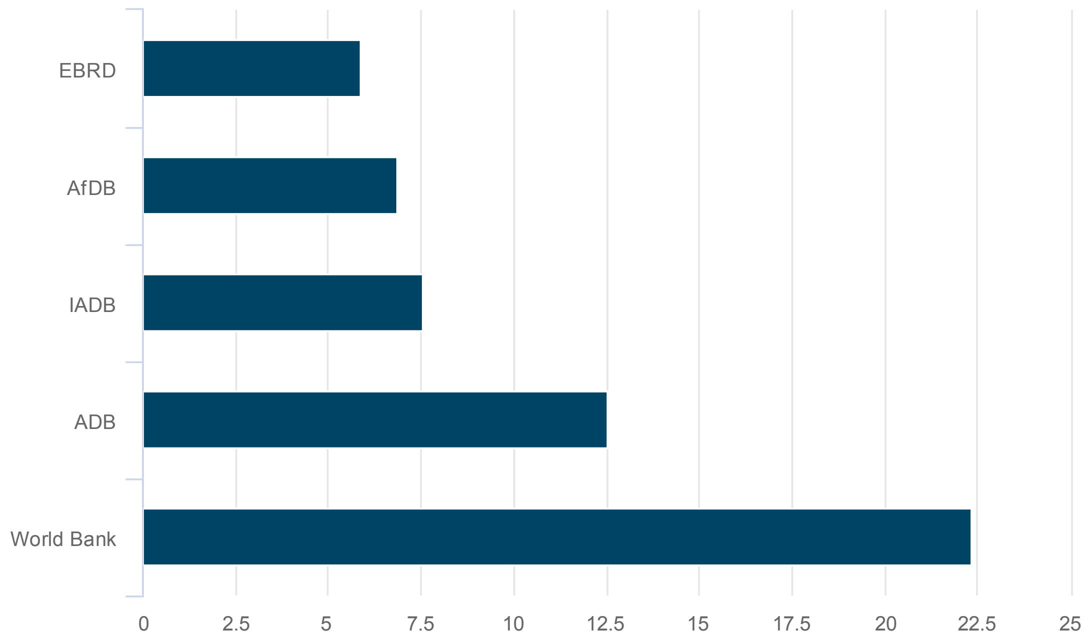
Such a rapid expansion of operations brings with it the risk that the pressure to approve loans will override quality standards and a commitment to maintaining a high rate of disbursements. By not increasing its operating/administrative budget or technical assistance funds at a commensurate rate, the ADB is expecting economies of scale will enable it to continue to run effectively. To this end, President Nakao has only committed to increasing professional staffing rates by 130 new positions, or roughly 9 per cent, until 2020, and has made no assurances about technical assistance funding.[141] Every previous expansion of lending activities has been followed by a commensurate increase in the level of staffing at the Bank. The projected expansion over the next five years breaks that trend. The staff to lending ratio at the Bank will be at the lowest levels in the ADB's history by 2020.

Figure 12: General capital and staffing increases, 1968–2015



Note: Dashed red lines demark general capital increases
Sources: ADB annual reports; ADB lending database; authors' calculations

Figure 13: Staff to lending ratio across MDBs, 2015 (current US$ millions)

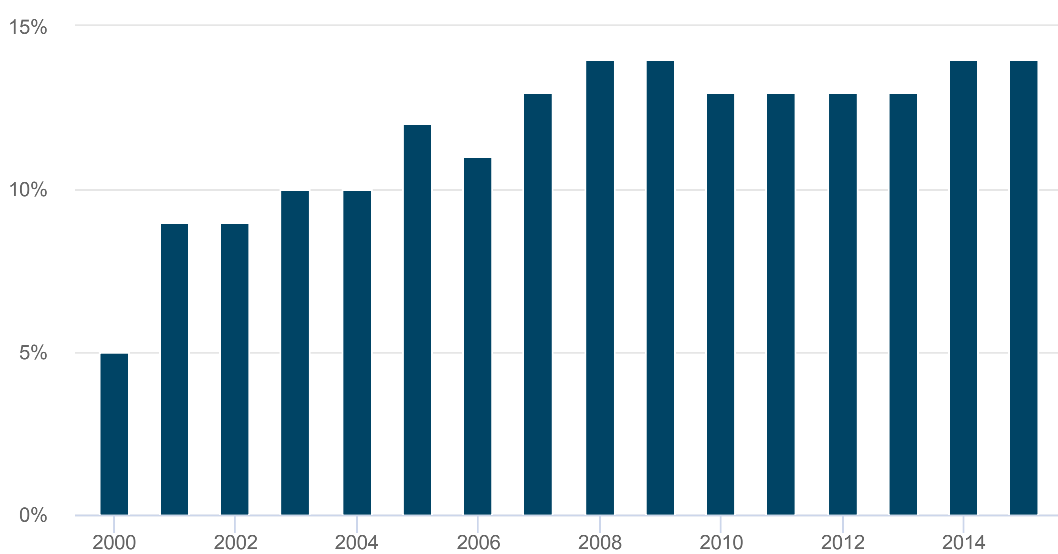


Note: This Figure shows the ratio of dollars lent per professional staff member, a proxy for lending efficiency; by this measure, when compared with the other regional development banks the ADB is the most efficient lender by a significant margin
Sources: MDB annual reports; authors' calculations

Staffing in the Bank is a controversial issue. Perspectives among stakeholders interviewed were split, with many arguing that it is a question of getting the right staff, rather than getting more staff overall, and noting that management needs to prove its commitment to reform and improving processes before more staff are hired. This, however, is a risk in an environment where the Bank now faces more lending competition than ever and heightened pressure to be the best performer in the region. The heightened pressure to approve and distribute expanded ADB lending should not be understated, and cannot come at the cost of either the project quality or technical expertise for which the ADB is known. There are both internal and external commentators who argue that there is still considerable room for improving internal efficiencies and that additional staffing increases are not necessary. While this position has merit, it must be weighed against the probability of such efficiencies actually being achieved in the next five years.

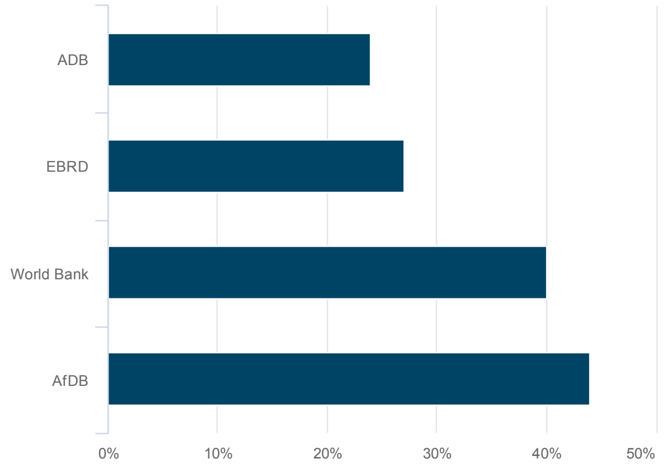
The ADB's workforce also remains highly centralised in Manila. As at 2013, 90 per cent of project processing and 60 per cent of project administration were led from Manila.[142] The ADB has among the lowest percentage of staff in the field of any MDB and relatively fewer operational activities and minimal authority delegated outside of Manila. A decentralised workforce would bring benefits of greater proximity to clients that would help in the design and delivery of projects, and would also help build and maintain client relationships.[143] Decentralisation would, however, also bring with it financial costs, a fragmentation of the centralised corporate hierarchy, and a potential weakening of inter-institutional knowledge sharing.[144]

Figure 14: Share of professional staff based in resident missions, 2000–2015



Sources: ADB annual reports; authors' calculations

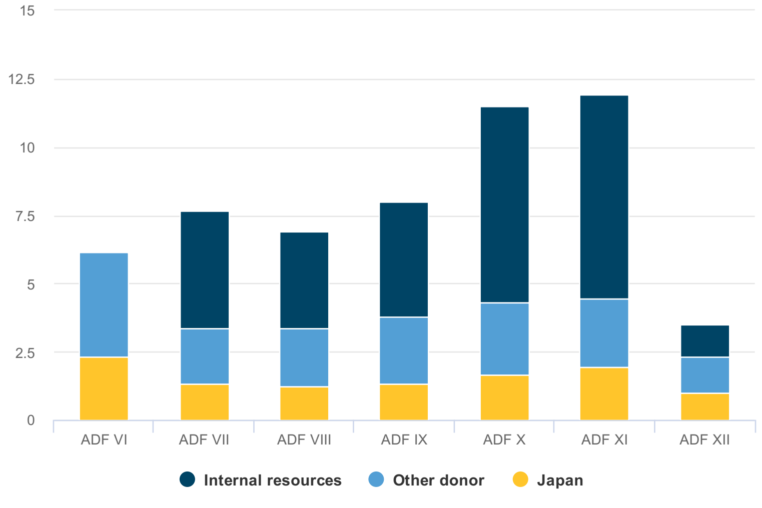
Figure 15: Comparison of staff decentralisation across MDBs (share of total staff based away from headquarters)



Source: MDB annual reports; authors' calculations

It is also possible that the capital merger will mean that donors will be less interested in investing in concessional financing through the ADB. The latest ADF replenishment received only half of the donor contributions compared with the previous round, which was both expected and encouraged by the ADB given its ability to now leverage this money in financial markets, and a considerable number of donors are yet to contribute. But now that donors have begun pulling back, there is a risk that they may continue to do so in the next replenishment.

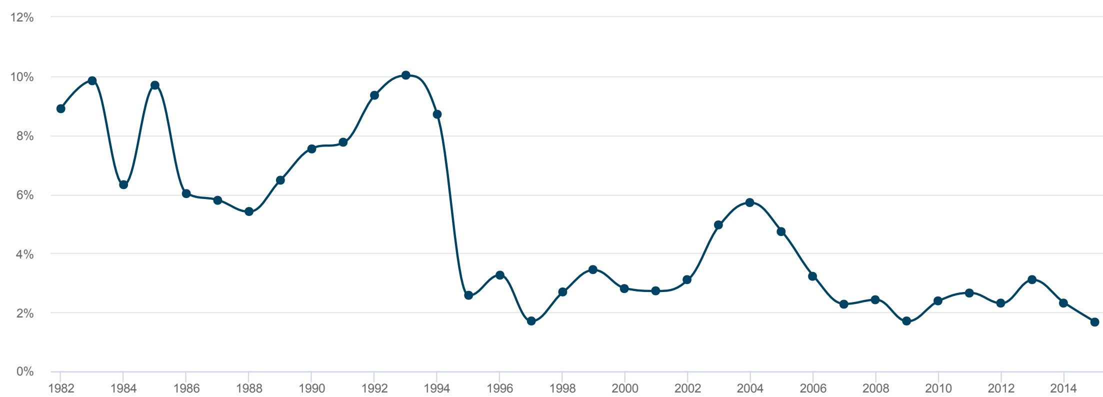
Figure 16: ADF replenishments — ADF VI–XII (nominal US$ billion)



Source: Authors' calculations based on ADB, "Asian Development Fund Replenishments", https://www.adb.org/site/adf/replenishments

The diminishing contributions to the ADF also creates a risk in terms of the Bank's ability to maintain a pipeline of bankable projects. While the infrastructure deficit in Asia has been well documented, responding to this deficit will require a lot of groundwork and design before projects can be proposed that will both return the ADB its investment and have a positive development outcome. This is where technical assistance comes in. Technical assistance at the Bank is a critical form of grant assistance that provides the capacity to work with recipient member countries to identify and construct bankable bids for ADB lending. It is a critical value add to the Bank's lending activities, particularly in countries with challenging regulatory or development environments. Technical assistance at the Bank has two critical challenges. The first is that these funds are messy and disparate, with donors setting up funds for particular regions or lending modalities. Many stakeholders complained about the difficulty of accessing these sources of funding. The second is that technical assistance as a share of ADB lending is declining over time. With the merger of the two lending arms of the Bank, there will also be less pressure for donors to provide funding from which technical assistance has typically been drawn.

Figure 17: Technical assistance as a share of ADB lending, 1992–2014



Note: This graph has been smoothed
Sources: ADB annual and financial reports; authors' calculations

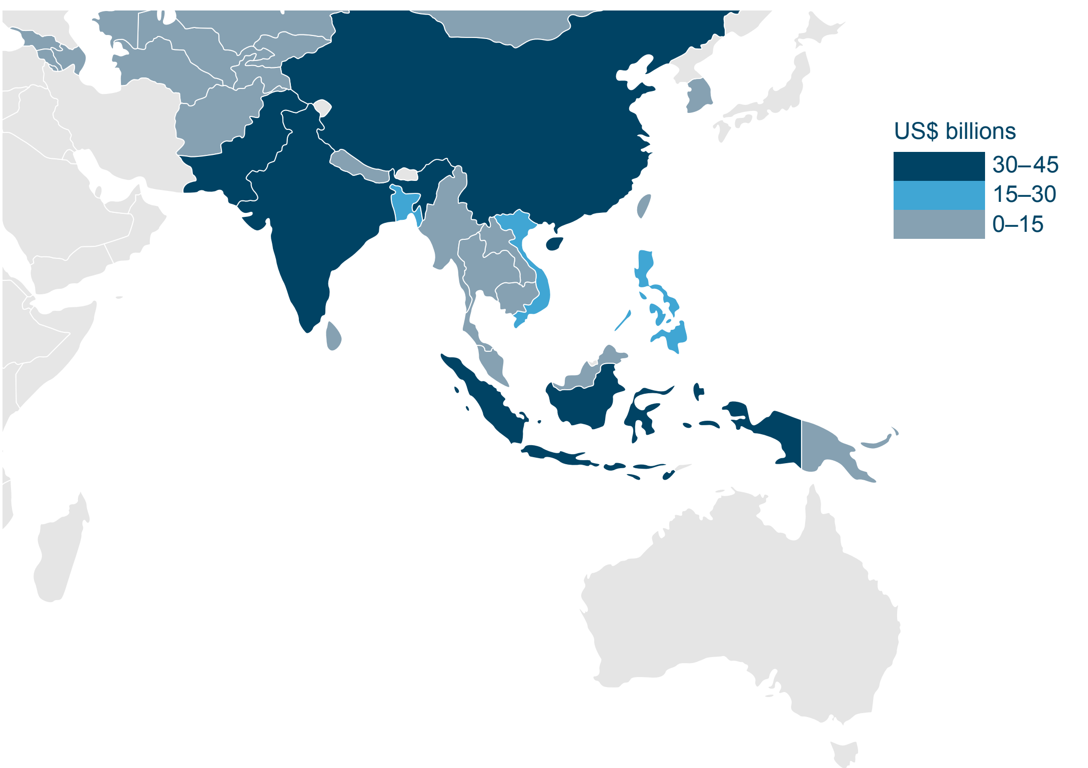
While the risks of the merger are significant, and the ADB will need to take further measures to ensure they are insured against those risks, the ADB should be commended for the move. The merging of its lending arms has enabled it to dramatically expand its lending operations, and defer a potentially messy general capital increase for another decade at least. The hard work of managing this merger is still ahead of the Bank, and it must not become complacent and let pressure to lend overwhelm the other elements of the Bank's operations that give the ADB its natural lending advantage.

Over the longer term, the merger of the funds does bring the future of the ADF into question. The ADB expects that member countries eligible for concessional lending and grants will rapidly decline in the short- to medium-term horizon. This could in turn result in the ADF becoming a much smaller program, which could potentially be funded entirely from the ADB's income, removing the necessity for future donor contributions. This would mark a significant change in the relationship between the Bank and its developed country members (such as Australia) whose influence in Bank decisions is primarily felt through generous ADF contributions. Alternatively, the ADB could widen its ADF engagement to focus on climate risk mitigation and other regional public goods which have significant externalities.

WHO THE ADB LENDS TO

The ADB's lending portfolio has also changed over time. Currently, 40 countries have access to development finance from the Bank; 17 have access to the ADF only; 12 have exclusive access to OCR; and 11 have access to both. Figure 18 illustrates just how much the pattern of lending from the ADB has changed over time.

Figure 18: ADB lending, 1968–2015



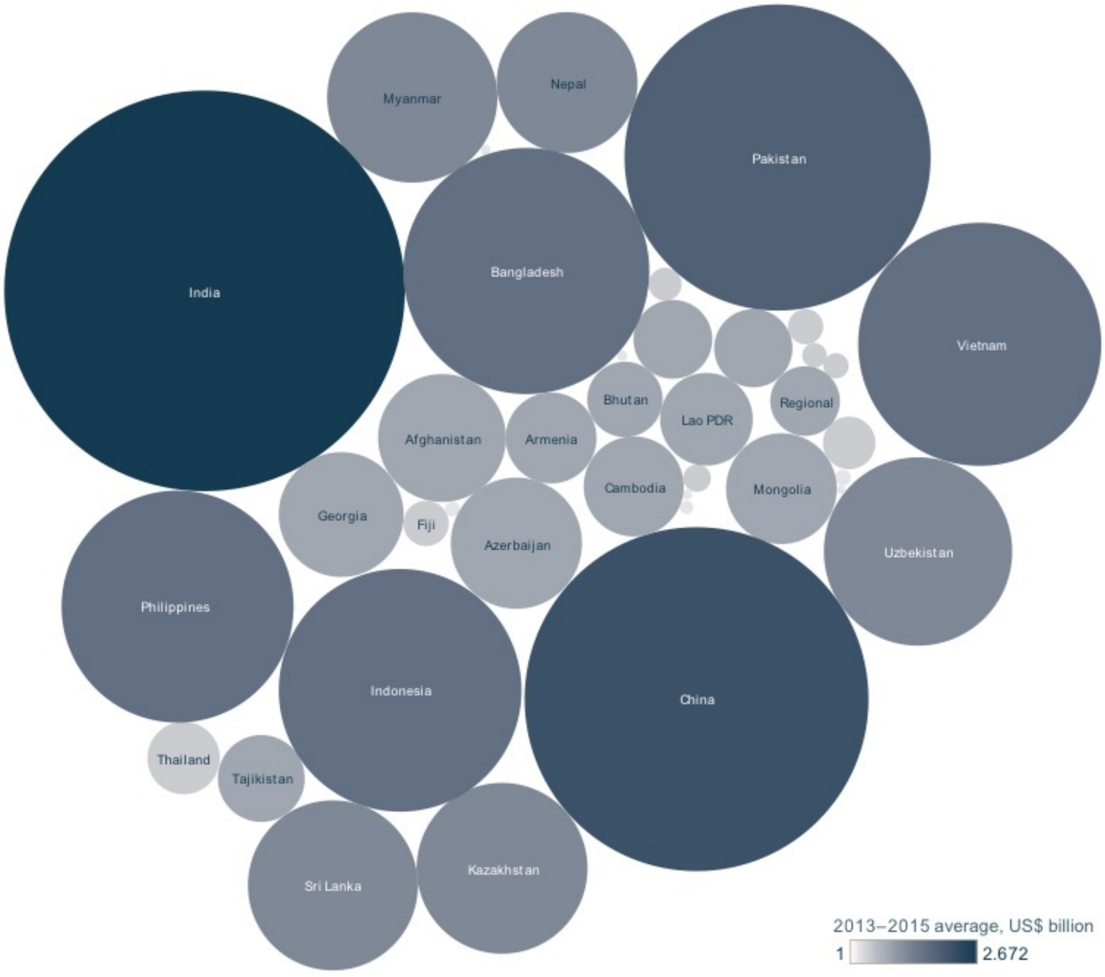
Source: ADB lending dataset

Despite this proliferation of recipients of ADB lending, the vast majority of loans are still concentrated in a small number of countries. When taking a three-year average (to account for major loans in some years and not others):

- Between 1980 and 1983, 73 per cent of approved loans were concentrated in five countries, and 97 per cent in the top 10.
- Between 2000 and 2003, 74 per cent of approved loans were concentrated in five countries, and 90 per cent in the top 10.
- Between 2012 and 2015, 55 per cent of approved loans were concentrated in five countries, and 80 per cent in the top 10.

Figure 19 shows the top 10 recipients in the 2013–2015 period. Interestingly, there is a similar trend when the ADB's concessional lending is isolated, where 61 per cent of loans are concentrated in five countries and 84 per cent of loans are concentrated in the top 10.

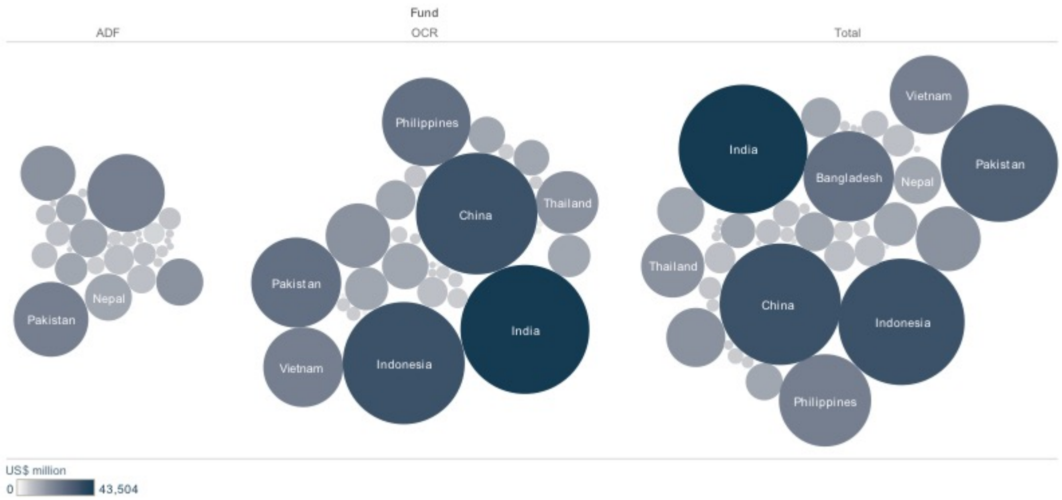
Figure 19: Top ADB recipients, 2013–2015



Source: ADB lending dataset

There is a similar trend when looking at aggregated lending over the full history of ADB operations, where 60 per cent of total lending over the past half century has been concentrated in five countries, and 82 per cent in the top 10.

Figure 20: Top 10 ADB recipients, 1968–2015



Source: ADB lending dataset

Despite this heavy concentration, it is important to emphasise that the remaining share of total lending still amounted to $11.3 billion in inflation adjusted terms over the past three years, and $54 billion over the history of the Bank's operations, roughly 18 per cent of all lending over that period. This is not an insignificant amount. It is also worth noting that if this lending was measured in per capita terms, lending would look far less concentrated. The ADB has necessarily focused its lending where the largest populations of Asia reside.

ADB lending is also concentrated in larger middle-income countries throughout Asia that have the capacity to absorb, effectively implement, and repay loans of the scale the ADB is now able to provide. These loans are typically provided on profitable terms for the ADB, making these borrowers critical to the ADB's ability to maintain its credit rating and meet its operating expenses. They are also important to the Bank's ability to meet the new lending demands they now face thanks to the expansion of their operations.

This highly concentrated majority of lending also makes sense from a development perspective. The nations that are consistently in the top 10 are those that can effectively pay back their loans. They are also the largest countries in the region, and home to a large number of Asia's remaining poor. Lending to such countries is justifiable both because of their size but also because of their continued need.

THE PRESSURE TO GRADUATE

There is, however, one large and significant risk associated with concentrating so much of the ADB's lending into so few, relatively prosperous, countries — the pressure to graduate. The ADB faces a situation where many of its traditional major borrowing partners have already technically passed the income threshold to graduate out of ADB lending, and more will no doubt graduate in the years to come. This creates issues both around the sustainability of the ADB's expanded lending, but also the sustainability of the ADB itself.

The existing graduation policy from the ADF only looks at development through a narrow lens of GNI per capita and creditworthiness. For OCR funds, attaining "a certain level of development by key economic and social institutions" is an additional condition.[145] However, as discussed in Chapter 2, there are still acute development needs in these countries, with more poverty in Asia now residing in middle-income countries than those eligible for ADF resources.

Table 6: ADB's graduation thresholds, GNI per capita

Fund	2012 US$
ADF	$1205
OCR	$7115

Source: ADB, 'Operations Manual: Bank Policies', 4 September 2013, https://www.adb.org/sites/default/files/page/30786/files/oma1.pdf

The ADB would not have to be concerned about poor people in middle-income countries if these countries were capable of addressing poverty without international assistance. The overwhelming evidence is that this is not the case for most middle-income countries.[146] Across the world, it is has been shown that public resources (domestic revenue and access to international finance) as a share of GDP fall in countries when they achieve middle-income status because international assistance often decreases faster than tax revenues rise.[147] This dilemma is discussed in the Introduction of this chapter and captured in Figure 7, and has become known as the 'missing middle' of development finance. There is little evidence to suggest when countries might pass this missing middle threshold, particularly at the graduation threshold that has been set for OCR lending.

A short supply of development finance in middle-income countries across Asia, combined with the need to still address poverty in these countries, means there are no development grounds that justify the ADB's graduation policy. The policy comes into further question in the context of the ADB's lending trends, where the majority of lending has been concentrated in Asia's largest countries. These are also often the countries that provide profitable returns for the Bank, which stakeholders argue enables the Bank to do more work in poorer countries. In the context of a rapid expansion in available lending, lending to all of Asia should be perceived as a win-win, particularly when it comes at such a marginal cost to donors.

It is important to note that while the ADB's graduation policy is in principle narrow and inflexible, in practice it operates with more flexibility than just the measures of per capita GNI and creditworthiness, with Board approval to graduate depending largely on the third condition of attaining "a certain level of development". This affords the Board a large degree of discretion when assessing member graduation from OCR funds, and explains why six countries currently eligible for lending have already exceeded the threshold set out in Table 6. Even with this degree of flexibility, the ADB's current graduation policy, for the reasons outlined above, still sets a very low bar. In the future it will become a hurdle in enabling the ADB to maintain some of its advantages as being a lender to the majority of the region as a further six member countries are expected to exceed the threshold by 2030.[148]

The ADB has recognised graduation policy as one of the most important issues confronting the future direction of the ADB, and commissioned a comprehensive assessment of that policy from the Overseas Development Institute.[149] The report identifies five policy options for graduation from OCR lending (Table 7). The report delivers a wide range of recommendations beyond these broad graduation policy recommendations, and is illustrative of the complexity and importance of reforming the ADB's current graduation policy to one more suited for Asia in the 21st century.

Table 7: Policy options for graduation from ADB lending

Graduation based on publicly available thresholds/indicators for all criteria	Status quo	Increased flexibility in exit	Voluntary graduation	No graduation policy
Each criterion is transparent and measured by quantitative indicators	Current ADB policy with criteria (ii) and (iii) based on subjective assessments	No strict timetable/path for graduation with flexibility in managing exit	A DMC decides whether and when to apply for graduation from regular assistance	DMCs have an indefinite option to borrow from ADB resources

Source: Prizzon et al, *Graduation from ADB Regular Assistance: A Critical Analysis and Policy Options*, 6

In addition to these recommendations, the ADB could consider reforming its graduation policy in more ambitious ways. It could base its lending criteria on more comprehensive measures such as the UN Human Development Index or the Multidimensional Poverty Index.[150] It could focus on more poverty clusters than simply two arbitrary thresholds.[151] It could focus on sub-sovereign lending in countries with high degrees of rural-urban duality and inequality. It can also look to move away from the income classification model altogether and instead assess countries on a case-by-case rolling basis. In the long run, it could consider shifting its mandate to become more aligned with the European Investment Bank's model and operate as Asia's long-term poverty-oriented lending institution. As one stakeholder in consultations explained, "there is no reason that the ADB shouldn't continue to follow all of its members along their development pathways", continuing to lend to high-quality public good projects across all of its Asian member countries.

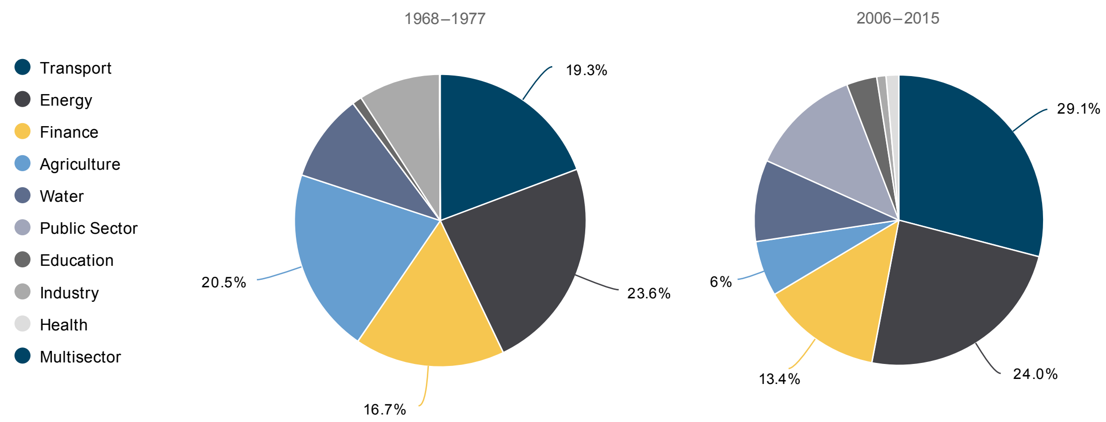
CHANGING LENDING MODALITIES

Along with the expansion of its activities and the countries in which it operates, the ADB has significantly changed the sectors to which it lends, the way in which it lends, and what types of institutions it lends to.

Sectoral lending patterns

While conventional lending at the ADB has always been dominated by infrastructure investment, the sectors to which it lends have significantly changed since the Bank's inception.

Figure 21: ADB sectoral lending, 1968–1977 and 2006–2015



Sources: ADB lending dataset; authors' calculations

The most dramatic shift in lending patterns when you compare the first ten years of ADB operations (1968–1977) with the last ten years (2006–2015), has been the decline of investment in the agriculture sector. This has gone from 20 per cent of total lending to 6 per cent and has largely been replaced by lending to the public sector through policy-based lending.

Engaging with the private sector

The ADB has expanded the range of institutions to which it lends. For most of its history, the Bank has lent exclusively to the national governments of their member states. In the 21st century, however, the ADB has expanded its lending portfolio to include the private sector, through the provision of what is known as non-sovereign finance. By engaging directly with the private sector, the ADB can have a major impact in unlocking much larger investments from the private sector that otherwise would not have been feasible. The ADB is particularly proud of its engagement with the private sector, an area in which it has come a long way in just a short period of time. In 2001, only $68 million was lent to the private sector, 1 per cent of total lending. In 2015 this was up to $2.6 billion, 16 per cent of total Bank lending. The ADB expects to systematically expand assistance for private sector development and operations to 50 per cent of annual operations by 2020, although it is not clear how much is expected to be delivered in the form of non-sovereign lending.[152] Stakeholders, however, provided very mixed views about the ADB's performance in the private sector space, with more than one interviewee arguing that the ADB's private sector models are in-house, Manila-based, and not as good as the International Finance Corporation, the World Bank's private sector lending arm.

The ADB is particularly eager to engage with the private sector through private-public partnerships (PPPs). PPPs are an interesting infrastructure investment model because they can help "to increase the availability, quality, and resilience of infrastructure and public services, while sharing the risk involved in providing them with the private sector".[153] PPPs are difficult to get off the ground in developing countries because many countries have ill-defined PPP policies, stringent capital controls, weak regulatory or legal systems that intensify risk, and shallow or illiquid capital markets that complicate exit strategies.[154] The ADB can help alleviate many of these downside risks by providing technical expertise and supplementary funding to make PPPs more attractive to investment from the private sector. To this end, the ADB has set up a $73 million technical assistance fund to focus solely on creating a pipeline of PPP projects.[155] PPP's will play a significant role in the ADB achieving its target of private sector-oriented lending by 2020. For this very ambitious target to be successful, the ADB will need to ensure a pipeline of bankable projects while helping the private sector alleviate risks that have prevented investment in PPPs in member countries in the past.

The evolution of sovereign investments

Despite the expansion of non-sovereign lending in recent years, 92 per cent of all lending in the ADB's history has been sovereign in nature. This has typically come in the form of pure investment-based lending, whereby the ADB provides a loan for a project (often developed in collaboration with ADB technical assistance), such as a bridge or a dam, to be repaid over a predetermined time frame. In the 21st century, the ADB has begun to expand its experimentation with new methods of sovereign-based lending.

The first way in which sovereign investments have evolved is through policy-based lending, essentially a form of budget support that is delivered in conjunction with structural reforms and pre-committed expenditure programs. Proponents argue that it is another way of effecting change by supporting reform in the policies or the policy-related institutions that can accelerate development processes in a country. Critics argue, however, that it can often be ineffective, intrusive, and corrosive.[156] While originally piloted almost four decades ago in 1978, policy-based lending at the Bank has gone through dramatic change since 1987. The Bank has learnt that the key to success is for recipient countries to have ownership over the suggested reform packages.[157]

This style of lending is particularly appealing to middle-income countries, which argue that the money attached to ADB lending is less important than the technical expertise that it brings. Also important is the 'halo effect' that ADB lending provides in encouraging other sources of finance, such as private sector lending and investment. However, some donor members within the Bank argue that it is just a way for the ADB to get money out the door to meet their yearly lending targets with loans that have little justification of additionality and development impact.[158] Nevertheless, policy-based lending is a key way in which the ADB engages with its middle-income recipient members. In 2010, policy-based lending made up 11 per cent of total ADB loans. A 20 per cent ceiling of policy-based lending is currently in effect.[159]

The second way in which the ADB is changing the character of its sovereign investments is by piloting results-based lending, which was only approved by the ADB's board in 2013. Results-based lending has three main tenets. The first is that disbursement of funding is linked to specific indicators, meaning that the ADB will only release the funds if they see tangible results. The second is that the funding is aimed at leveraging and anchoring existing government programs, thereby providing an incentive for increased performance of much larger amounts of domestic expenditure. The third tenet is the use of existing government systems.

Results-based lending has been championed by development practitioners for its potential to improve program effectiveness by, among other things: encouraging governments to shift domestic priorities; drawing results to the attention of politicians and managers; establishing accountability to constituents; and giving recipients discretion to engage in local problem-solving.[160] The use of government systems has caused some consternation among many donor countries for fear of reduced quality, safeguards, corruption, and fungibility. On the other hand, it has the potential to directly improve country systems and realign recipient incentives that aid has failed to achieve in the past. Currently, the ADB has put a 5 per cent limit on results-based lending as a share of total lending until the pilot projects can be properly evaluated.[161]

There is also potential for sovereign lending to continue to evolve in the coming decades through new lending models. The ADB could consider piloting investments in political risk insurance that may bring about greater private sector engagement. Political risk insurance protects private investment from the risk that regime instability or other political conditions will result in a loss. In recent years, the value of investment guarantees has averaged about 3 per cent of total FDI flows, but about 30 per cent of FDI inflows to developing countries.[162] By offering these types of insurance at low rates to the private sector, the ADB could bring into effect further private sector investment in many of its member countries.

Additionally, the ADB could also begin to engage in sub-sovereign lending in middle-income countries — that is, lending to specific states or regions within a country. This would have the dual benefit of targeting the ADB's investments to where they are most needed and alleviating pressures from certain members to graduate countries out of ADB lending. The World Bank has been conducting such lending since 2003, and in 2009 had committed over $1.2 billion in sub-sovereign funding.[163] There are legitimate concerns about the risk of sub-sovereign lending having the potential to encourage over-privatisation, unfunded decentralisation, and over-indebtedness.[164] However, given the share in overall expenditure that sub-national governments are responsible for in many countries, the benefits of dealing with them outweigh these risks.

BOX D: THE ROLE OF KNOWLEDGE AT THE ADB

Producing and managing knowledge is perceived by many, particularly within the ADB, as a critical function of MDBs. Their size and breadth enables them to be centres of technical expertise and determine 'best practice' development. Their long-standing engagement with developing nations gives them a wealth of country-specific experience. The World Bank's seminal 1998 *World Development Report* on the importance of knowledge to development identified three roles that MDBs could play in reducing knowledge gaps:

1. Provide international public goods.
2. Act as intermediaries in the transfer of knowledge.
3. Manage the rapidly growing body of knowledge about development.[165]

Since that report was published, knowledge is perceived to be a critical comparative advantage to the services that the MDBs provide in contrast to all other forms of development finance.

To that end, knowledge management has become a critical objective for the ADB, with "knowledge solutions" identified as one of the five major drivers of change in Strategy 2020.[166] To meet this objective, the ADB has significantly scaled up its investment in knowledge creation. Between 2004 and 2011, it produced a daunting 5138 knowledge products, increasing publication output fivefold between 2007 and 2011 alone. Knowledge-related technical assistance was also over $270 million in 2011.[167] In 2011, the Bank's budget for knowledge products made up 11 per cent of its operational budget.[168] The World Bank, self-described as the "knowledge bank", has a comparative operational budget of 31 per cent for knowledge production.[169]

Despite this strong financial and very sporadic strategic investment in knowledge management, consultations for this report revealed knowledge to be an area of significant weakness for the Bank. The Bank is seen as too rigid in its intellectual approach, too culturally risk-averse to push intellectual boundaries, too fragmented in its focus, unaligned with demand from donors, duplicating the research of other MDBs, and lacking the research standards of other institutions such as the World Bank and IMF. These perspectives are echoed in the ADB's own 2012 independent review of knowledge management, which found implementation of the 2004 agenda to be rated "less than successful".[170]

There has been much written about how to reform knowledge management in MDBs, particularly from within their own evaluation units.[171] In addition to these evaluations, stakeholders had multiple suggestions for how the Bank's knowledge management should be reformed to make it a regional leader in this space, including:

- The Bank should move to develop a simple, cohesive, and unified strategy of how knowledge will be managed across every part of its operations, not just the research arms.
- The ADB will never be a knowledge creator like the World Bank without dramatically increasing its knowledge products expenditure. It should instead look to better align its operations and knowledge services to become a centre for best practice technical knowledge on its key areas of focus, such as energy, transport, and infrastructure.
- The Bank should look to reduce the volume of knowledge products it produces and focus on improving quality.
- The Bank should move away from economic analysis products (notably the Asian Development Outlook), that often replicate work done by the World Bank and IMF and which have little value-add or shelf life. It should instead focus on products that deliver development/investment lessons in Asia.
- The Asian Development Bank Institute, an autonomous unit based in Tokyo and fully funded by the Japanese Government, should be redefined as a training and capacity-building institute, allowing knowledge management to be centralised under ADB auspices.
- The Bank should work to create a comprehensive and centralised knowledge portal for information and data (including lending information) that is accessible to the general public.

CONCLUSION

The nature of development finance in Asia is dramatically changing and the ADB must continue to evolve if it is to remain an important player in the 21st century. New sources of finance are available, while member countries can rely more heavily on domestic resources to finance their own development. There remains, however, a critical infrastructure deficit in the region that most streams of development finance cannot fill alone. In this context, the ADB is still an important lender to the region. While scaling up its lending operations, the ADB must be conscious of maintaining its comparative advantages of project quality and expertise. To make sure that it retains its position as a lender of choice for all of Asia, it will need to address graduation policy, ensure adequate levels of high-calibre staffing, maintain a pipeline of bankable projects, and continue to experiment in new lending modalities all the while becoming less sclerotic and bureaucratic.

RECOMMENDATIONS

THE ADB'S 21ST CENTURY CHALLENGES

The ADB faces three major challenges in the 21st century: navigating the evolving geopolitical dynamics of Asia; fulfilling its mandate for economic development and poverty reduction while responding to Asia's changing economic geography; and harnessing alternative economic models to remain a source of finance.

It is important not to underestimate the volatility of geopolitical tensions in Asia. China's assertive rhetoric combined with its size and strength make it more confident about challenging the status quo in the region, even at the risk of aggravating its neighbours. Meanwhile, a new Trump administration means there is now significant uncertainty about the role that the United States will play in the region and how it deals with China, its key allies, and other countries.

The economic development of Asia is widely lauded as a great success story. Hundreds of millions of people have been lifted out of poverty in the past two decades. But these impressive statistics obscure the fact that half the world's extreme poor people still live in Asia even if many of the countries of the region are now categorised as 'middle income'. The boundaries of poverty are changing and no longer necessarily align with national borders. The focus needs to be less on poor countries, and more on poor people. And growing inequality also needs to be factored into how we view Asia's poverty reduction success story.

The slowing of some previously dynamic economies underlines the lesson that development trajectories are rarely linear. The ADB has correctly identified regional priorities for infrastructure and connectivity, and the management of environmental degradation and climate change. Tectonic shifts in demography and urbanisation present another range of policy challenges.

The nature of development finance is also changing. As Asia develops, it can draw on alternative sources of international finance as well as its own domestic resources to fund its development and infrastructure needs. This has fed the notion that a publicly financed development bank in Asia is less relevant as the region becomes more prosperous. But these new sources of finance are unable to replace the work of the ADB let alone meet the vast infrastructure financing deficit across the region. The region is desperate for bankable projects and the knowledge, technical expertise, and policies that are required to implement them.

RESPONDING TO THE CHALLENGES

The ADB is well placed to respond to these challenges. Against the background of shifting geopolitical dynamics, it can leverage its history of quality projects and high standards. However, the Bank does need to reform its governance and its graduation policy. The Bank should meet the new demands of Asian countries (e.g. protection against climate change) while staying anchored as a development bank focused on alleviating poverty. The ADB should increase its lending across all of Asia using its expanded capital base, while also experimenting with new types of loans.

REMAIN NEUTRAL

The ADB's strength is that it is a neutral political actor that can appeal to both donors and borrowers. While new development actors have been perceived as vehicles for geopolitical aims, the ADB can rely on its record of consensus decision-making and its history of effective projects and successful development outcomes. If the new MBDs propose new and different standards, the ADB should double down on its commitment to 'best practice' and high standards, while at the same time working to improve its responses to Asia's changing needs. The ADB has the advantage of a strong legacy and the benefit of having learned hard lessons from past development failures. Despite persistent frustrations with its methodologies and requirements — some justified but others simply reflecting impatience — it now offers a set of well-proven and effective standards which would be unwise to reject.

> *Recommendation 1: The Bank's role as a well-respected neutral development actor is even more important as geopolitical tensions and uncertainty in Asia mount. To underpin this role, it should be more vocal about the value of its development credentials and the high standards they represent.*

BROADEN REPRESENTATION

Ownership of the ADB is still skewed towards the United States and Japan. Japanese leadership provides generous and stable support for the Bank. Given the economic size of China and India, these two countries should have a bigger say at the Bank, on the condition that they are willing to contribute more to the Bank's finances. The Bank risks losing relevance if China and India become less interested in supporting the ADB because of the influence they have in the region. The sheer geographic size of both countries means they are critical for regional connectivity, and they will continue to host the majority of poor people in Asia.

Giving more voice to China and India will not be a smooth process for the ADB. Both countries have until now focused on their own needs rather than what is necessarily best for the Bank (e.g. seeking loans, procurement contracts, and promoting their staff). But the ADB should aspire to remain 'Asia's bank' and this means sharing governance among Asia's main players. Giving more ownership to other Asian members at the exclusion of China, by contrast, would likely increase competition between the AIIB and the ADB. Over time, China and India can help positively shape the Bank within its existing mandate, working with Japan and the United States through consensus decision-making.

> *Recommendation 2: The ADB needs to work towards more representative governance with a greater voice for regional members. This requires giving China and India more influence, while not compromising the Bank's existing mandate.*

KEEP COLLABORATING

The ADB is already acting as a collaborative partner with the new multilateral banks, and has the opportunity to transfer good practices. Co-financing with the AIIB is a good sign for future cooperation. The ADB can be part of regional initiatives such as China's Belt and Road where there are good projects with transparent processes. The development challenges of Asia will need engagement from all the regional MDBs.

Recommendation 3: The ADB should keep engaging with new actors in the region.

FOCUS ON POVERTY

Poverty remains a major feature of Asia's economic landscape. As the region's development bank, the ADB should continue to play a strong role in facilitating development policies, programs, and reforms that are essential to reducing poverty. The Bank should do this by staying focused on infrastructure, as well as the environment and climate change. Not only is fighting poverty critical to the ADB's mandate, but this focus sets it apart from the new multilateral banks in the region and other forms of international finance.

Recommendation 4: Addressing poverty should remain the first priority of the Bank through maintaining its focus on infrastructure and connectivity as well as environmental issues, particularly the impact of climate change.

While a handful of stakeholders wanted the Bank to ratchet up its efforts in health and education, these arguments fail to address how the Bank would access the resources to do so while maintaining its efforts in its existing core areas of work. There is a real risk that the ADB might be encouraged to fill in the gaps resulting from reduced bilateral aid budgets, although the Bank's own resources would not be supplemented to do so. While it is a truism that the Bank needs to be guided by its members, it is also true that members need to accept the limitations of what the Bank can take on and instead ensure that is focuses on its strengths.

Recommendation 5: ADB shareholders and management need to accept that the development agenda is much bigger than what the ADB and its resources can manage. Focus needs to be maintained to stop the Bank straying from its strengths.

The ADB should continue to play to its inherent strengths: its ability to apply safeguards and protocols which are widely recognised as 'best practice'; its role as an honest broker, particularly at the sub-regional and regional level, where its facilitating role can cut through otherwise competing agendas; and its support for the efforts of developing member countries to put in place the legal and regulatory frameworks required to make the operating environment more attractive and predictable for the private sector. It also needs to continue to be a champion for projects that contribute to the public good but which would not otherwise be funded because they have limited profit potential.

Recommendation 6: The ADB should continue to play to its strengths and champion those projects that contribute to the public good but which might not otherwise be funded.

CHANGE THE GRADUATION POLICY

One of the most important questions that the ADB must address is that of graduation. To mould the ADB into a long-term poverty-oriented lending institution fit for Asia in the 21st century, the Bank's graduation policy must be reformed. When looked at through a development lens, there are no grounds to justify the ADB's existing graduation policy. Many of the Bank's major lending partners have already technically passed the graduation threshold but still suffer from significant development challenges. ADB lending is also highly concentrated in the larger economies of Asia. This lending, which is profitable to the Bank and comes at a marginal cost to donors, enables the ADB to lend more in member countries with more acute development challenges. Furthermore, excluding the largest economies in the region will also undermine one of the ADB's major comparative advantages: its role in regional integration and as an honest broker across Asia.

A full suite of recommendations on the ways in which the ADB's graduation policy can be reformed can be found in Chapter 3. These are all valid reform options for the stakeholders of the Bank to consider. In the long run, the Bank should be operating as Asia's long-term poverty-oriented lending institution for all of Asia, regardless of income thresholds within particular countries. Given the ADB's strong track record, its small cost to member countries, and the continuing infrastructure needs in Asia, this is an argument that ADB members should strongly consider.

> *Recommendation 7: The ADB's graduation policy must be reformed.*

NEW LENDING MODALITIES

The Bank will need to continue to experiment with new lending modalities to best leverage its lending muscle and better catalyse and improve domestic investment. While overall ADB lending is relatively small, it will continue to play a critical role in unlocking much larger sums of private and public finance. The ADB's lending activities have evolved over time, from engaging directly with the private sector to lending to governments in new and innovative ways. This should continue. The ADB can continue to evolve the way in which it engages in sovereign lending by piloting investments in political risk insurance, as well as sub-sovereign and local currency-based lending to insure against exchange rate volatility.

At the same time, the Bank should not forget about its concessional lending to low-income countries. Given this report's recommendation that the ADB should maintain its focus on poverty, it follows that the ADB should resist the urge to significantly wind down its concessional lending activities. The ADB should look to maintain or increase the level of funding it received in the latest ADF replenishment to allow it greater flexibility in the future to engage in anti-poverty lending and to support regional public goods.

> *Recommendation 8: The Bank should continue to experiment in lending in creative ways and maintain its portfolio of concessional lending activities.*

KEEP THE FOCUS ON QUALITY

A critical element of the ADB's appeal as a partner of choice in the region is the quality of its projects. Given the expansion that the ADB is currently engaged in, there is significant risk that both portfolio and project performance could suffer as pressure mounts to push loans out the door. With the heightened lending competition in the region, the quality of ADB lending is critical now more than ever. The ADB will need to make sure that portfolio and project performance continues to improve while it dramatically expands its lending. This will not be an easy task. A key element of managing this will be balancing the emphasis on project design and appraisal.

The ADB deserves credit for its impressive performance in both rigorous evaluation and transparency. It ranks in the top 10 donors in the annual Aid Transparency Index.[172] However, many stakeholders interviewed emphasised that the review and evaluation process is now too layered and cumbersome. The ADB should consider conducting an independent assessment of its evaluation practices in an effort to streamline its processes while still promoting rigorous evaluation. Additional resources should be put into project planning and preparedness to address the root cause of project performance. Finally, stakeholders expressed concerns about contracting and procurement processes and the need to improve the supervision of contract implementation.

> *Recommendation 9: The ADB needs to maintain high standards in all stages of a project's lifecycle. This includes front-end planning, contracting and procurement, as well as back-end project supervision, monitoring, and appraisal.*

Project quality can also only be ensured if the Bank is adequately and professionally staffed. While there are grounds to justify improving staffing efficiency, the risk of not adequately staffing the Bank for its new lending portfolio outweighs the potential efficiency gains. This is particularly pertinent for a multilateral bank that is already comparatively lightly staffed. A staffing increase would also help to attract new talent to the Bank and prevent new banks 'poaching' staff from the ADB. This should be considered only after a comprehensive and independent human resources assessment to identify gaps in expertise, which could then be used to guide the Bank's hiring practices in the future and assist in streamlining existing structures and inefficiencies within the current body of ADB staff.

> *Recommendation 10: The Bank should consider a general staffing increase comparable with those that have followed past general capital increases.*

Equally as important as maintaining adequate staffing numbers in the Bank is staff quality and efficiency. Stakeholders throughout this process have noted that the ADB is encumbered by rigid staffing quotas, glacial and opaque hiring practices, and a lack of competitive hiring processes at the highest levels of management. This has led the ADB to be more concerned about experience and knowledge of bank processes, rather than innovation and adaptability, which has particularly de-emphasised the role of junior staff members. One interviewee was concerned that senior ADB management was sometimes used as "a dumping ground for unwanted officials", a sentiment shared by others but also a problem no doubt shared by all international agencies that lack fully transparent hiring practices. The best way to reform this process is to demonstrate a greater degree or meritocracy by opening up its hiring policies at all levels, including senior leadership and the Board of Directors.

Recommendation 11: The ADB must open up its hiring policies at all levels of the Bank.

Another element of project quality will come from the Bank ensuring that it maintains a pipeline of bankable projects, not just for itself but for the region as a whole. Quality infrastructure projects in Asia will require groundwork and long-term planning facilitated by the ADB's technical assistance. The ADB should streamline its technical assistance trusts into a unified pool (with appropriate quotas for various modalities). It should also invest more profits into technical assistance funding to ensure that technical assistance remains at an adequate ratio to lending volumes.

Recommendation 12: Funding for technical assistance should be streamlined and maintained at appropriate levels to create a pipeline of bankable infrastructure projects in Asia, not just those that the Bank looks to invest in.

Finally, the ADB has been criticised for being too slow and bureaucratic, and for not adequately addressing the needs of its clients. One way in which the Bank could improve its client relationships is by further decentralising its staff to improve their proximity to lending partners. The ADB has among the lowest percentage of staff in the field of any development bank, and decision-making is highly centralised in Manila. Recommendations from the 2013 independent review of the Bank's decentralisation should be reassessed and adopted.[173] In adopting a broader decentralisation agenda, the ADB must be wary not to let it run too far by maintaining a strict management hierarchy. Many stakeholders wanted the ADB to avoid the "chaos" of the World Bank's decentralisation efforts and regular organisational reforms. There is scope for further staff decentralisation, but it must be managed in a way that ensures a strict hierarchy is maintained.

Recommendation 13: Staff and decision-making should be further decentralised from Manila, while maintaining an appropriate hierarchy.

THE ADB IN THE 21ST CENTURY

When there is geopolitical competition, multilateral institutions are naturally under strain. In Asia, the power dynamics have changed rapidly yet poverty persists and the Asian Development Bank now has to respond to new development challenges. Despite the criticisms of some members and frustrations of some partners, the Bank has delivered good development outcomes throughout the Bank's 50 years, contributing to the remarkable economic and social change across the region. The Bank will have to work even harder to maintain its standing as Asia's development bank in an increasingly fraught geopolitical environment and in the face of new and more flexible sources of finance. To do this, the Bank will need to address core development challenges in the region, including poverty, poor infrastructure, climate change, changing demography, and urbanisation. The Bank's continuing evolution demands a clear vision, smart leadership, and confidence in its own role as a major facilitator for good development across the region.

NOTES

[1] These are Afghanistan, Armenia, Azerbaijan, Bangladesh, Bhutan, Brunei Darussalam, Cambodia, China, Georgia, Hong Kong, India, Indonesia, Japan, Kazakhstan, South Korea, Kyrgyzstan, Laos, Malaysia, Maldives, Mongolia, Myanmar, Nepal, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Tajikistan, Thailand, Timor-Leste, Turkmenistan, Uzbekistan, and Vietnam.

[2] A comprehensive database of ADB lending was provided to the authors by the ADB. References to the database are listed as 'ADB lending database'.

[3] The 'Bretton Woods' regional MDBs are understood to be the African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Inter-American Development Bank. "About the Bretton Woods Institutions", The Bretton Woods Committee, 2016, http://www.brettonwoods.org/page/about-the-bretton-woods-institutions.

[4] ADB, *1968 Annual Report*, https://www.adb.org/documents/adb-annual-report-1968.

[5] ADB, "Who We Are: Fast facts", 2016, https://www.adb.org/about/main.

[6] ADB, *Strategy 2020: The Long-Term Strategic Framework of the Asian Development Bank 2008–2020* (Manila: ADB, 2008), https://www.adb.org/sites/default/files/institutional-document/32121/strategy2020-print.pdf.

[7] ADB, "Road to 2030: ADB's New Strategy", 2016, https://www.adb.org/about/policies-and-strategies/new-strategy.

[8] Asian Infrastructure Investment Bank, "About Us", 2016, http://www.aiib.org/html/aboutus/AIIB/.

[9] New Development Bank, "Agreement on the New Development Bank — Fortaleza, July 15", http://ndb.int/charter.php.

[10] Junhua Zhang, "What's Driving China's One Belt, One Road Initiative?", *East Asia Forum*, 2 September 2016, http://www.eastasiaforum.org/2016/09/02/whats-driving-chinas-one-belt-one-road-initiative/?utm_campaign=shareaholic&utm_medium=twitter&utm_source=socialnetwork.

[11] ADB, *Infrastructure for Supporting Inclusive Growth and Poverty Reduction in Asia* (Manila: ADB, 2012), https://www.adb.org/sites/default/files/publication/29823/infrastructure-supporting-inclusive-growth.pdf.

[12] ADB, "Frequently Asked Questions: Enhancing ADB's Financial Capacity by Up to 50% for Reducing Poverty in Asia and the Pacific: Combining ADB's ADF OCR Resources", 31 March 2015, http://www.adb.org/news/features/frequently-asked-questions-enhancing-adbs-financial-capacity-50-reducing-poverty-asia.

[13] ADB, "Classification and Graduation of Developing Member Countries", Operations Manual: Bank Policies, 4 September 2013, https://www.adb.org/sites/default/files/page/30786/files/oma1.pdf.

[14] The voting power of the two major shareholders is less than their actual shareholdings — 12.8 per cent for Japan and 12.7 per cent for the United States: ADB, "Members, Capital Stock, and Voting Power (as of 31 December 2015)", Organizational Information, *2015 Annual Report* (Manila: ADB, April 2016), https://www.adb.org/documents/adb-annual-report-2015.

[15] Three directors represent a single country, those representing the United States, Japan, and China.

[16] To date, there has never been a female ADB president.

[17] ADB lending database.

[18] ADB, "ADB Approves Record $27 Billion in 2015 to Meet Asia's Development Needs", News Release, 8 January 2016, http://www.adb.org/news/adb-approves-record-27-billion-2015-meet-asias-development-needs.

[19] Raphaëlle Faure, Annalisa Prizzon and Andrew Rogerson, "Multilateral Development Banks: A Short Guide", Overseas Development Institute, December 2015, http://www.odi.org/publications/10160-multilateral-development-banks-short-guide.

[20] ADB, "Frequently Asked Questions: Enhancing ADB's Financial Capacity by Up to 50% for Reducing Poverty in Asia and the Pacific: Combining ADB's ADF OCR Resources", 31 March 2015, https://www.adb.org/news/features/frequently-asked-questions-enhancing-adbs-financial-capacity-50-reducing-poverty-asia.

[21] Ibid.

[22] Ibid.

[23] ADB lending database.

[24] Barry Naughton, *The Chinese Economy: Transitions and Growth* (Cambridge: MIT Press, 2007), 3.

[25] Merriden Varrall, "Chinese Views on China's Role in International Development Assistance", *Pacific Affairs* 86, No 2 (June 2013), 233–255. Growth and infrastructure have always been part of the international development agenda, but Western donors have added other priorities. One interpretation is that China is not so much offering an alternative but rather rejecting the 'new approaches' of Western donor countries.

[26] Scott Morris, "Responding to the AIIB: US Leadership at the Multilateral Development Banks in a New Era", CFR Discussion Paper, September 2016, http://www.cfr.org/asia-and-pacific/responding-aiib-us-leadership-multilateral-development-banks-new-era/p38251.

[27] Johannes F Linn, "Are the Traditional MDBs in Trouble?", *Future Development* (blog), Brookings Institution, 29 May 2015, http://www.brookings.edu/blogs/future-development/posts/2015/05/29-development-banks-linn.

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[29] Zheng Wang, "Not Rising, but Rejuvenating: The 'Chinese Dream'", *The Diplomat*, 5 February 2013, http://thediplomat.com/2013/02/chinese-dream-draft/.

[30] Barack Obama, "President Obama: The TPP Would Let America, Not China, Lead the Way on Global Trade", *Washington Post*, 2 May 2016, https://www.washingtonpost.com/opinions/president-obama-the-tpp-would-let-america-not-china-lead-the-way-on-global-trade/2016/05/02/680540e4-0fd0-11e6-93ae-50921721165d_story.html?utm_term=.be758636c178.

[31] The term 'Washington Consensus' was penned by the academic John Williamson in 1989 but it is used more generally to describe a blueprint approach to liberalisation and privatisation. There is ongoing economic debate about the best way to open up markets.

[32] Many Asian countries also have a large number of reserves that serve as self-insurance — leading to saving rather than spending — even though their economies need investment.

[33] World Bank and IMF, "World Bank Group Voice Reform: Enhancing Voice and Participation of Developing and Transition Countries in 2010 and Beyond", 19 April 2010, http://siteresources.worldbank.org/DEVCOMMINT/Documentation/22553921/DC2010-006(E)Voice.pdf.

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